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Business Week
July 7

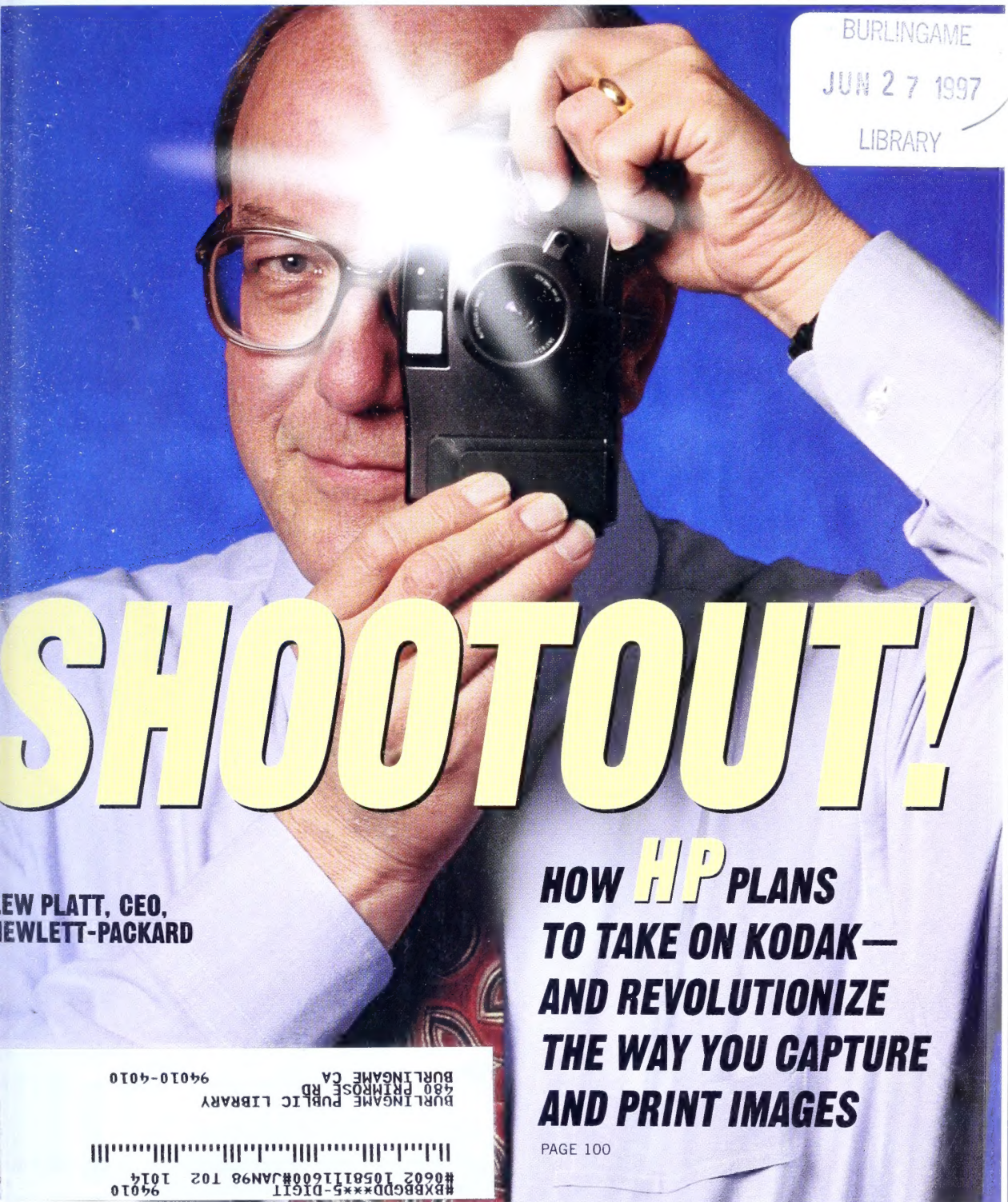
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BusinessWeek

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SHOOTOUT!

EW PLATT, CEO,
HEWLETT-PACKARD

**HOW *HP* PLANS
TO TAKE ON KODAK—
AND REVOLUTIONIZE
THE WAY YOU CAPTURE
AND PRINT IMAGES**

PAGE 100

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**THE NETWORK AGE
IS ABOUT TO BECOME BIGGER
THAN THE INFORMATION AGE.
ARE YOU READY?**





Information
technology and communi-
cations technology have converged.

∞ Multimedia (voice, data, video, voice mail, e-mail, Internet, Intranets) can all move through the same networks. If you can keep it all moving quickly and reliably, it can make your company a lot more productive, and more profitable. ∞ Which is where Fujitsu comes in. ∞ Our ATM switching systems deliver multimedia content at warp speed across public networks and enterprise networks. Our Computer Telephony Integration systems put information in your hands, whenever and wherever it's needed. Our high-speed SONET transmission systems are used by more local exchange networks than any other. And no one has more experience integrating all these technologies into networking solutions that reduce costs and increase revenues. ∞ So when you're ready to move into the network age, just remember, Fujitsu is ready to take you there.


FUJITSU

COMPUTERS, COMMUNICATIONS, MICROELECTRONICS

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Light refreshment, thanks to PET (polyethylene terephthalate). Due to its special properties, PET is being used as a packaging material in more and more areas of daily life.



R 12540 BW

Trevira

A member of the Hoechst Group

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This 1.5-liter bottle made from PET plastic weighs a whole 45 grams.

That's a fraction of the weight of a glass bottle. (And PET won't fracture.)

*PET plastic –
so only the contents
carry any weight.*

So you're not weighed down by the packaging, just its contents. What's more, it can be easily recycled. So it's easy come, easy go.

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Finding new ways.

Hoechst 



BusinessWeek

JULY 7, 1997

Cover Story

100 SHOOTOUT!

Hewlett-Packard, the king of computer printers, is set to take on the likes of Kodak and Fuji with an array of digital imaging gear—from scanners to “mailboxes” to combination cell phone-cameras—that, in the words of CEO Lew Platt, will “fundamentally change the way people think about photography”

108 KODAK'S DIGITAL DEVELOPMENTS

The photo powerhouse plans to roll out new digital products every six months

News: Analysis & Commentary

34 THE TOBACCO DEAL'S NEW SHAPE

Opposition groups, notably one led by C. Everett Koop and David Kessler, say the devil is in the details

36 IS LIGGETT GETTING BURNED?

It's crying foul as other tobacco companies gang up against it

38 COMMENTARY

Antismoking activists and others agree: The deal with Big Tobacco is no victory for public health

39 GLOBAL WARMING SINGES CLINTON

The President's retreat from a campaign pledge to take action on greenhouse gases could cost him

40 SPEED BUMP AT CHRYSLER

With sales skidding, CEO Eaton takes a hard look at costs

41 BIG OIL TO BEHEMOTH OIL

Savings now will come from consolidation, not joint ventures

44 COMMENTARY

Why Andrew Young's report on foreign workers doesn't do it for Nike's critics

45 LIFE AFTER NAFTA

Doomsday didn't come, but workers have lost leverage

46 MEGAPLEX MANIA

The movie theater industry is on the brink of consolidation—and more screens

47 INSIDERS, WATCH YOUR BACKS

A new Supreme Court ruling sharpens the SEC's enforcement power

47 CISCO BULKS UP FOR BATTLE

The networking champ takes the lead in an industrywide buying spree

48 IN BUSINESS THIS WEEK

The Global 1000

52 A NEW BREED OF BLUE CHIPS

This year's global winners are less superefficient, boast global brand names, and give shareholders lot of value. And more than ever, America dominates the list

91 ALPHABETICAL LIST OF COMPANIES

94 EMERGING MARKETS, RUSSIAN STILL

Moscow's mammoths make the list—help the rebound from 1995's pessimism

95 EMERGING MARKETS: THE TOP 10

Economic Analysis

26 ECONOMIC VIEWPOINT

Becker: How to fix Europe's job crisis

30 ECONOMIC TRENDS

Bias still blocks blacks, bond spreads health costs plummet—for employers

31 BUSINESS OUTLOOK

Summer's pleasant surprise: Exports are sizzling

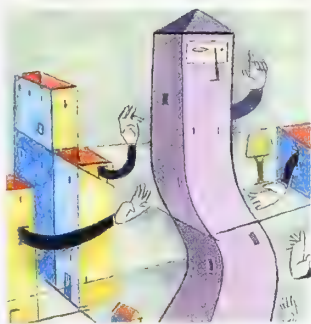
126 AN ECONOMY ON STEROIDS?

New Commerce numbers may show that U.S. growth has been much more robust than previously thought

VER STORY

TOUT!

r powerhouse
t-Packard has
ne future and it
hotography?
vision includes
th of new
ts page 100



LOCAL BRAWLS

Are U.S. cities
overstepping their
bounds? page 98



OMIC
LE
ata
veal
ed-up
rowth

THE
GLOBAL
1000

The balance of
power again shifts
toward the U.S.

page 52



HOSPITAL CLOUT

Quorum profits
from its low-key
takeover style page 110



NOT SO FAST

As critics weigh in, a very
different tobacco deal may
emerge page 40



JUNK IS BACK

But have bond
investors forgotten
that high yield is
high risk? page 116

overnment

ASHINGTON OUTLOOK

inton is talking compromise on
oduct-liability reform

egal Affairs

ING BEYOND CITY LIMITS?

ocal government bodies are exercising
eir clout on social issues—and
usiness is balking

he Corporation

UORUM YES, COLUMBIA/HCA NO

oth run for-profit hospitals, but
mmunity leaders favor the former
ese days

ports Business

CAN LIFT THE NAME OF BOXING?

scar De La Hoya hits—and pitches

inance

I BONDS, THE JUNKIER THE BETTER

vestors are stampeding to high yield.
ut are they setting themselves up for
fall?

118 BIG STINK, BIG BANG

Using corruption as political cover,
Prime Minister Hashimoto speeds
financial deregulation

119 MUD ON MORGAN'S WHITE SHOES?

San Diego critics are alleging conflict
of interest in a lucrative trash-hauling
privatization deal

120 COMMENTARY

Clearing firms ought to police
themselves against bad apples

122 INSIDE WALL STREET

149 INVESTMENT FIGURES OF THE WEEK

Environment

128 THE BLACK MARKET VS. THE OZONE

Despite global limits on producing CFCs
—which primarily go into the air
conditioners of older cars—traffic is brisk

Science & Technology

131 DEVELOPMENTS TO WATCH

An electronic bike with power-assist
pedals, "plasma-wave" electronics, a
device that irrigates blood clots

134 A REVOLUTION IN MEDICAL IMAGING?

Digirad's 50-pound device could replace
3,000-pound gamma-ray cameras

Personal Business

140 HOME: Hiring the right contractor

SOFTWARE: CD-ROM feasts for the eye

Features

6 UP FRONT

12 EDITOR'S MEMO

16 READERS REPORT

16 CORRECTIONS & CLARIFICATIONS

21 BOOKS

Kanigel: *The One Best Way: Frederick
Winslow Taylor and the Engima of
Efficiency*

23 TECHNOLOGY & YOU

Test-flying the new Pilot palmtop
computer

147 BUSINESS WEEK INDEX

148 INDEX TO COMPANIES

150 EDITORIALS

Why rush a deal on tobacco?

Global warming requires cool heads

BUSINESS WEEK ONLINE: Internet: www.businessweek.com America Online: Keyword: BW

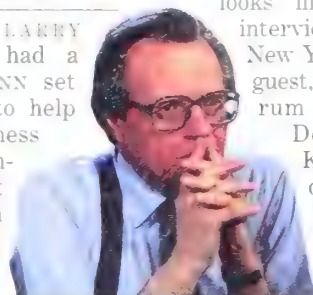
Up Front

EDITED BY LARRY LIGHT

TALKING HEADS

A LARRY KING SHOW YOU NEVER SAW

TALKMASTER LARRY King recently had a guest on his CNN set who paid him to help promote a business venture. The interview wasn't broadcast on *Larry King Live*. But the business, a proposed group of personal-help



DUPED into an infomercial?

clubs called the Resource Forum, showed a tape of it at the venture's Atlanta launch. The King spot appears to give Resource Forum the cachet of national TV exposure, even though it never aired.

The episode is another embarrassment for CNN. Reporter Jonathan Karl recently had to ask Visa to pull an ad he appeared in. CNN President Tom Johnson O.K.'d the King segment yet now admits fouling up. "I didn't know this was a commercial pitch," he says. "This is totally unacceptable and against

policy." King, who won't comment, donated his \$2,500 fee to his heart-patients charity.

The 8½-minute segment looks like a regular interview in King's New York studio. His guest, Resource Forum chief Allan DeNiro, says King never endorsed the biz. King does say on the tape: "I really like this idea." The spot was shown to 400

prospects for Resource Forum, which plans 300 clubs offering career and personal counseling for a \$1,000 entrance fee and \$39 a month. DeNiro wrote Johnson that the spot would screen just once.

The imbroglio started when DeNiro, former human-resources head at CNN's parent, Turner Broadcasting System, wrote Johnson asking for a King interview to be shown at "a private conference" on "the decline in employer-employee relationships" and other "support systems." Brad Wolverton

TALK SHOW "We hope the U.S. will engage in efforts to maintain foreign-exchange stability so we don't have to succumb to the temptation to sell off U.S. Treasury bills."

—Japanese Prime Minister Ryutaro Hashimoto, in remarks that—after stocks skidded—an aide said were misinterpreted

STREET NEWS

MAKING A MARKET OUT OF SNIFFLES

WALL STREET LATELY IS securitizing willy-nilly. It sells bonds backed by the upcoming payments, called receivables, for everything from delinquent child support to David Bowie's royalties. Among asset-backed securities, what's getting attention now? Health care, a largely untapped—but growing—area with billions in receivables.

Smith Barney created a buzz on the Street last year by securitizing drugstore receivables in an \$80 million private placement for the Pharmacy Fund, which administers bill payments electronically. A \$120 million secondary offering is on tap for the fall.

The Pharmacy Fund is eyeing a major expansion further into the medical field. Executives say they are talks with one of the nation's largest hospital chains to package its bills be packaged into securities. Pharmacy Fund says it is also negotiating for similar ventures with a leading medical laboratory and a huge doctors' consortium.

Lots of Wall Street firms are eager to jump in on the deal or others. Executives at Lehman Brothers say the firm is vigorously pursuing health-care securitizing. In particular, Lehman hopes to bring to market a nursing-home and home health-care deal by the end of 1997. Lisa Sande



THE LIST FAT CITY IN MOTOWN

Corporate America's profit party, still going strong, has left many companies holding a lot of cash.

In the case of Detroit's Big Three, the thinking is to build a rainy-day fund for the next recession. In five years, Ford's cash kitty has doubled. And Chrysler's continues to grow despite \$4 billion in stock buybacks it began last year to satisfy Kirk Kerkorian. High-tech companies such as Microsoft are doing so well that, even with ambitious spending plans, plenty of cash is left.

LARGEST CASH STASHES

FORD MOTOR	\$18.5
GENERAL MOTORS	10.1
MICROSOFT	9.1
INTEL	8.5
IBM	6.5
CHRYSLER	6.2
BOEING	5.5
EXXON	5.3
COMPAQ COMPUTER	4.7
GENERAL ELECTRIC	3.6

In billions, cash and marketable securities; first quarter, 1997

SOURCE: STANDARD & POOR'S COMPUSTAT

THE KINGDOM

NOW, ANYONE CAN BE AN OIL SHEIKH

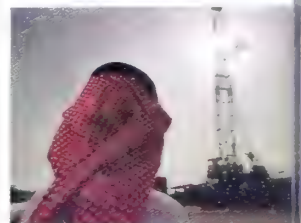
FOR YEARS, SAUDI ARABIA'S stock market was closed to investors outside the Persian Gulf region. But in early August, the first closed-end fund permitted to invest in Saudi Arabia will begin trading on the London Stock Exchange.

Managed by Saudi American Bank, a Riyadh-based Citibank affiliate, the Saudi Arabia Investment Fund will be the only way foreigners can buy into the oil-rich kingdom's petrochemical and other industries. Judging by early investor interest, the \$250 million initial offering may not be enough to meet demand, says a bank official.

The Saudi bourse has a lot going for it—a sizable \$50 billion market cap, an advanced computerized trading system, and bargain stocks selling at

less than 13 times earnings. The launch of the fund is only one of a series of financial reforms that could transform the cloistered Saudi economy. For example, Riyadh seeks to join the World Trade Organization.

Why the changes? The world's largest oil exporter can no longer offer jobs



SAUDI stock spigots open

all because of low oil prices and \$60 billion in Gulf War bills. So the kingdom hopes opening the spigots of foreign investment will reverse soaring youth unemployment with its potential for destabilization. John Ross



THE LIFEBOOK™

600

*The first-day-of-spring,
not-a-care-in-the-world,*

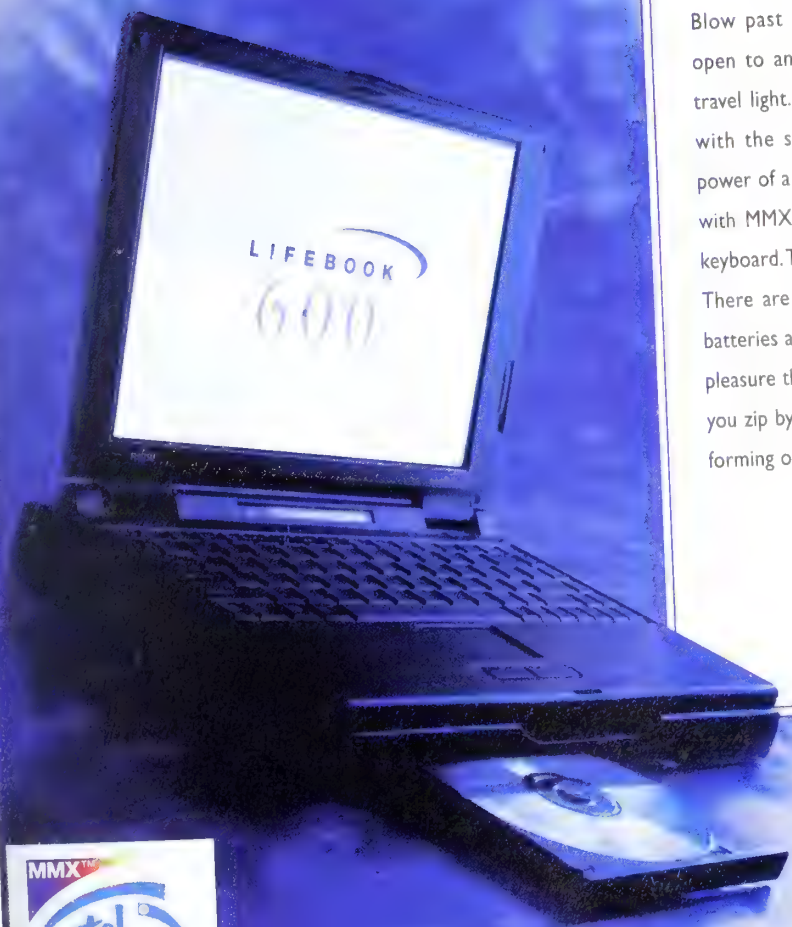
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Up Front

MURPHY'S LAW

ONE NAME, TWO COMPANIES, UMPTEEN FLUBS

SWISHER INTERNATIONAL IS hardly a household name. But two public companies share the moniker, much to the recent confusion of investors.

Swisher International



Group Inc. makes cigars. Founded in 1861, it went public in December on the New York Stock Exchange with the ticker symbol SWR. Then there's 17-year-old Swisher International Inc., a restroom-cleaning service, on NASDAQ as SWSH since its

1987 initial public offering. The stogie outfit generated 23¢ earnings per share for its latest quarter, vs. 7¢ for the hygiene company.

Goofs abound. In December, Commodity Systems Inc., a data provider to financial Web sites, gave cigar Swisher the historical stock quotes of restroom Swisher. And on Dec. 18, when cigar Swisher went public, some services subbed its price for restroom Swisher's, which suddenly seemed to gain 10 points. The flub wasn't fixed until May.

First Call, another data service, mixed up the twosome's differing fiscal calendars. Result: Dow Jones News Service thought cigar Swisher's first-quarter 23¢ per share was also its second-quarter results, so it failed to meet analysts' expectations by 9¢.

Why not just change the names? Since both are trademarked, neither company is eager to.

Lisa Sanders

CASINO SOCIETY

THE SWEET SMELL OF ... GAMBLING?

FOXWOODS IS BETTING LADY Luck needs a new perfume. America's largest casino, run by the Mashantucket Pequot Indian tribe, recently brought out its own private-label scent for female high rollers, who make up slightly more than half of its 55,000 daily patrons.

Despite going for \$220 an ounce, the fragrance is selling well. After a month, the Ledyard (Conn.) casino's boutique has moved over 200 bottles. Still, says the boutique manager, it hasn't outsold Tiffany, Issey, or Chanel.

The perfume is peanuts compared to poker and other

gaming. Foxwoods garnered \$858 million in revenue from its slots alone last year, according to Ladenburg Thalmann analyst Andrew Zarnett. But many casinos have high-end shops for clothing, jewelry, and the like, figuring that gamblers are a good retail target, since they're already feeling flush.

Chic private-label perfume, however, is sold in few other casinos. For the past 10 years, Caesars

HIGH TEST perfume

World has been selling scents for both men and women, now priced at \$185 an ounce. Foxwoods is so encouraged by its house brand's reception that it is thinking of selling it in stores around the country. *Leslie A. Brown*



DRAWN & QUARTERED



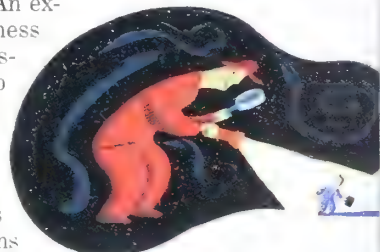
DIGGING FOR DATA

DUN & BRADSTREET GETS STREET SMART

DUN & BRADSTREET, THE business-information service, has a new tool to build its database: shoe leather. An explosion in small-business growth has D&B dispatching its staffers to cruise malls and Main Streets, notepads in hand, on the lookout for new enterprises.

D&B's old method was to wait for new editions of the Yellow Pages and other local business directories to come out. In recent years, though, industry leader D&B has faced increased competition, especially from Experian (formerly TRW). To maintain its lead—it has more than 20 million business listings—156-year-old D&B

three years ago started contest, paying \$800 to any of its 50 offices that add 35 new businesses per staffer to the database. The prize is divided among an office staffers, with the top producers getting the most.



The program first two years were a bust because few took the bounty seriously. But in 1996, after management push, the program provided 20% of the 2 million new listings. So far this year, D&B says the haul appears to be well ahead of last year's.

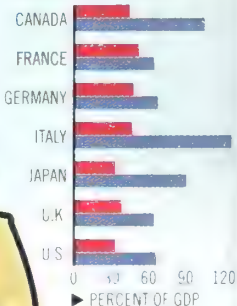
Roy Furchgo

THE BIG PICTURE

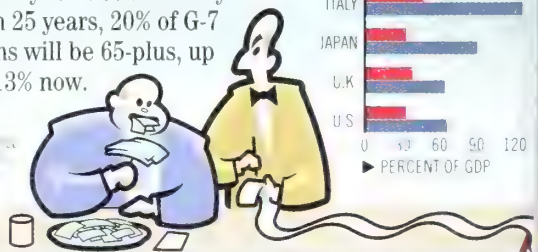
FISCALLY UNFIT

Taxes and debt are consuming big chunks of the industrialized nations' economic output, largely for social welfare costs, says Merrill Lynch's Jack Lavery. And in 25 years, 20% of G-7 citizens will be 65-plus, up from 13% now.

■ GENERAL GOVERNMENT RECEIPTS
■ GROSS PUBLIC DEBT



DATA: MERRILL LYNCH & CO.





*Occasionally, someone
ends up financially secure
by accident.
I'm here to help make
it happen on purpose.*

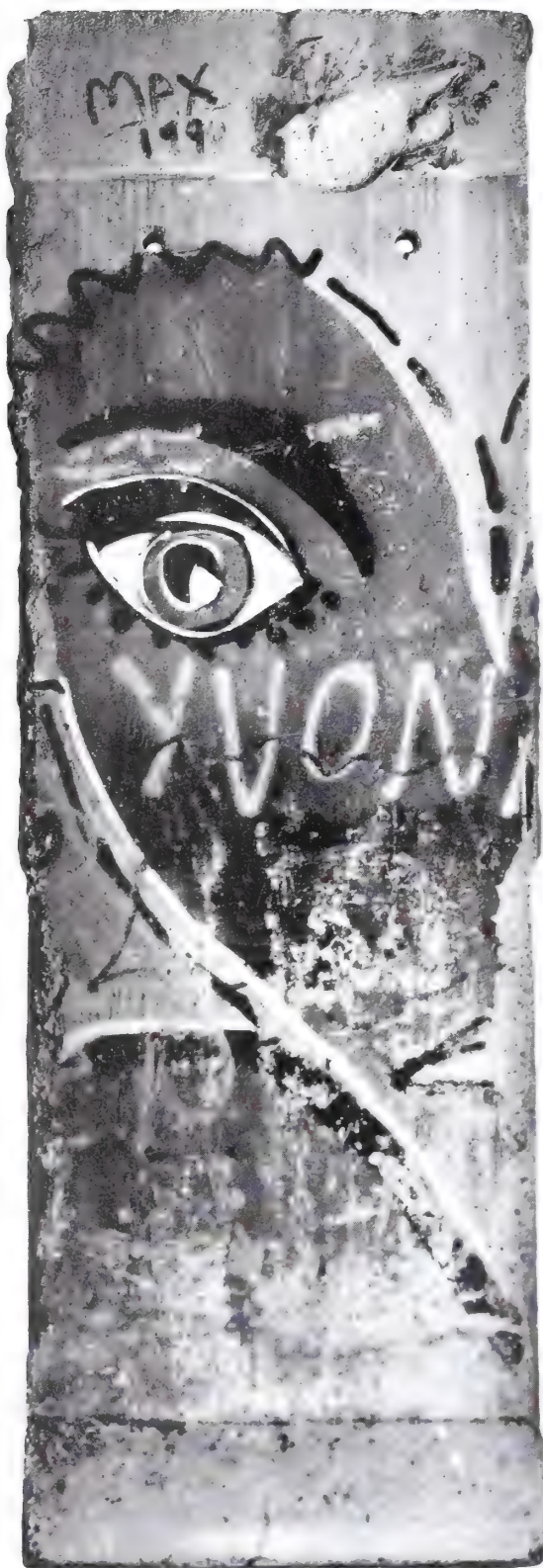
Jim Hatcher's job is all about goals. An American Express financial advisor since 1986, he knows that beginning with the end in mind is key. So that's what he helps you do. First by listening to what you want to accomplish financially. Then by helping you put together a plan so you might achieve it. Jim also likes to meet on a regular basis to take a look at progress, and make adjustments as things change. The way Jim sees it, the goal is important, but so is the journey. And if he has anything to say about it, both are going to be very worthwhile experiences. With advisors like Jim, it's no wonder 95 percent of our clients stay with us year after year.

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New York City.

The best corporate strategy for success in emerging markets is:

★ Import Plan.

★ Export Plan.

★★★★★ Marshall Plan.

The Marshall Plan built an economy so strong and so attractive that people knocked down the Berlin Wall to get to it.

And the key investment wasn't just money.

It was participation. Hands-on management. The exchange of knowledge. The idea of going there and building from within.

That's what United Technologies does today.

From China to Russia to Latin America, we don't just do business – we live there, work there and build companies there long before the competition shows up.

What are the advantages? Being there first gives us a shot at the best contacts, the best partners, the strongest positions and the greatest growth.

It's the kind of plan that builds companies. And countries.

Be there first.



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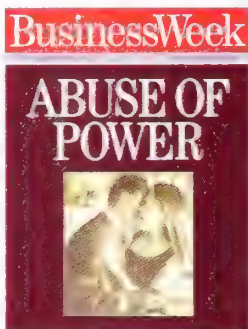
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HIGH PRAISE, INDEED

On June 30, BUSINESS WEEK will be receiving an important accolade: a Gerald Loeb Award for Distinguished Business & Financial Journalism honoring our May 13, 1996, Cover Story "Abuse of Power." The Loeb awards, presented by the John E. Anderson Graduate School of Management at UCLA, are the most prestigious in business journalism. BUSINESS WEEK had two other entries make it to the finals: "The Mob on Wall Street" (Dec. 16, 1996) and a series of stories that included "Warning! Bogus Aircraft Parts" (June 10, 1996).

U.S. Equal Employment Opportunity Commission completed a probe that found Astra had harassed numerous women and engaged in a coverup. Settlement talks are under way.

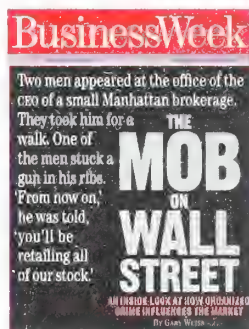
"The Mob on Wall Street," by Senior Writer Gary Weiss, was another high-impact investigative story. In March, the National Association of Securities Dealers told Congress it was probing securities firms and suspicious stock trading documented in our story. Willy Stern's pieces on air safety revealed that bogus parts were being sold to airlines and



May 13, 1996



July 15, 1996



December 16, 1996

We are especially proud of "Abuse of Power." Reported and written by Mark Maremont and edited by Senior Editor Jane Sasseen, the story was the result of a six-month investigation that started with a tip.

An insider at Astra USA Inc., the subsidiary of Swedish pharmaceutical giant Astra, called Maremont and told him a tale of rampant sexual harassment that stemmed straight from the CEO's office. Soon, Maremont began digging, interviewing some 70 current or former Astra employees.

His story led to a huge shakeup at Astra USA. Days before publication, the company suspended its U.S. chief, Lars Bildman. In February, the

raised questions about regulators.

The Loeb win caps an awards season that includes a Computer Press Assn. prize for "Inside Microsoft," a July 15, 1996, Cover Story. And as we reported earlier, BUSINESS WEEK was a finalist in the National Magazine Awards' general excellence category again this year after winning for two of the previous three years.

We are happy to have these awards and even happier that they demonstrate how effectively we are doing our job for you, our readers.

Mark Morrison

Managing Editor

Business Week

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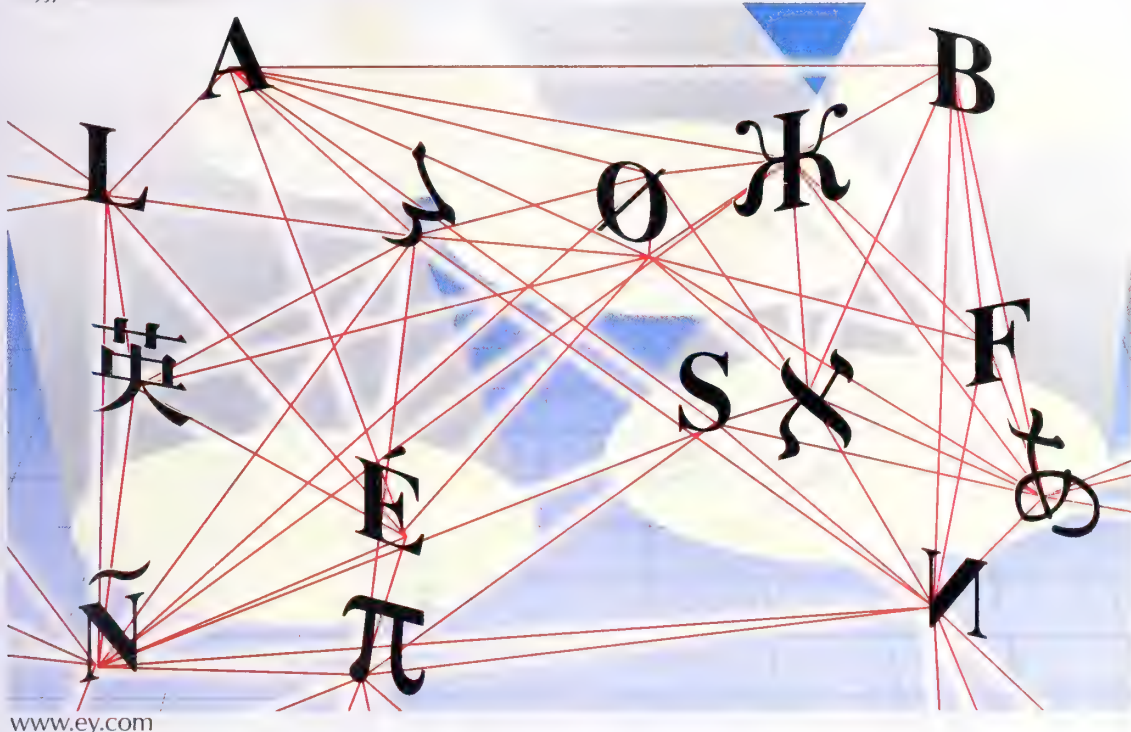
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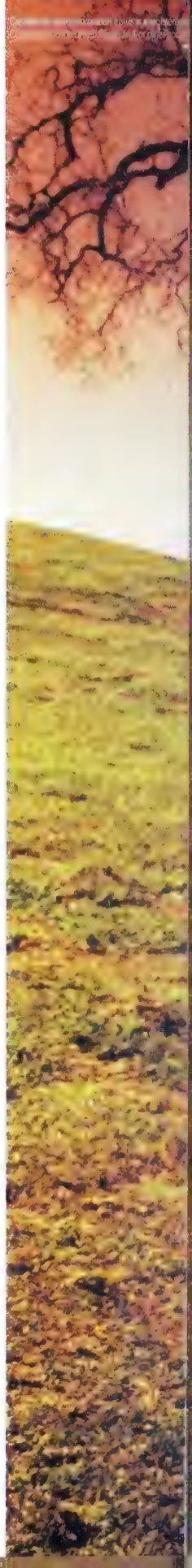
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Readers Report

WHAT'S SO STRANGE ABOUT STANDING UP TO CHINA?

"Weird bunch," huh? ("Don't let this weird bunch dictate America's China policy," Economic Viewpoint, June 16). I guess it's "weird" to be concerned about those who are being tortured, imprisoned, or murdered for their religious beliefs by a regime that forces women to have abortions and forcibly sterilizes them.

We all talk a good game about the gallantry of that one student facing a column of tanks at Tiananmen Square, but when it comes to putting that sentiment on the line, we can write a page of rationalizations. We have had people down through history who could find an economic rationalization for staying within the British Empire, for keeping slavery, for isolationism during World War II, for accommodating a brutal regime in the Soviet Union, and on and on. And yet here we are, the wealthiest nation in the world—and a morally bankrupt one.

Where would your columnist Rudi Dornbusch draw the line? Most-favored-nation status is for civilized countries that choose to behave as economic partners, not for those that torture their citizens for their religious beliefs and who physically punish their women for having babies. Let's take a stand, just once. Let's put aside the stone heart of a capitalist, come together, and do something to show that the U.S. can also assume the moral leadership of the world. If that's "weird," I stand accused—and proud.

James A. Driskell
Brockton, Mass.

Rudi Dornbusch makes a compelling case that China should be engaged, not isolated. It's a pity that, like most Americans who have made that argument, he lacks the courage to extend his argument to Cuba.

Rohan Oberoi
Somerville, Mass.

Rudi Dornbusch characterizes those of us supporting revocation of most-favored-nation status for China as a "weird... coalition" with "fringe agendas." How much weirder is an alliance between the Family Research Council and the AFL-CIO than one between the Chinese communists and American capitalists?

The core of Mr. Dornbusch's position seems to be that it is useless to hold "the predominant world power of the next century" accountable via trade

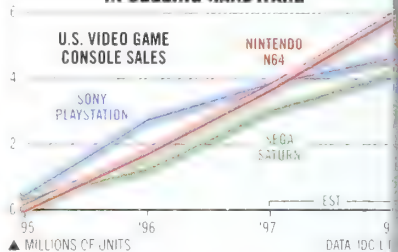
CORRECTIONS & CLARIFICATIONS

A table that accompanied "Leading light among the labs," (Information Technology Annual Report, June 23) contained some incorrect figures. The number of patents per researcher at Georgia Institute of Technology should be 0.05. And the correct figures for California Institute of Technology are: staff size of 27, with 20% on the faculty, research honors, and 0.3 patents per researcher.

"Universal's soon-to-be-lost world" (Entertainment, June 23) wrongly characterized the USA Network. In the first quarter of 1997, USA and TNT each reached about 1.1 million homes in prime time. The Cartoon Network was in 529,000 homes.

In "Nintendo: At the top of its game" (Information Processing, June 9), the chart showing video-game sales transposed Sony and Sega. Here is the corrected version, which includes updated information supplied by International Data Corp./LINK:

NINTENDO PULLS AHEAD IN SELLING HARDWARE



policy. Mr. Dornbusch may or may not be right in this prediction, but the history of American foreign policy furnishes many examples of the American people rising above economic advantage and power worship. That's what the most-favored-nation status debate is about.

Gary L. Bahr
President
Family Research Council
Washington

GIVE CLINTON CREDIT FOR THE HEALTHY ECONOMY

I read Paul Craig Roberts' article "What's so mysterious about the roaring economy?" (Economic Viewpoint, June 2) with great surprise. Mr. Roberts laments that "supply-siders do not get credit for the transformed economy they forecast."

Perhaps Mr. Roberts was not living on planet earth in 1993, but I was. When President Clinton's deficit-reduction





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Readers Report

tion package was passed, back in 1990, the supply-siders predicted that the U.S. economy would fall to pieces. Indeed, congressional Republicans who were hard-core supply-siders went so far as to predict the exact number of jobs that would be lost in their districts. The devastation they predicted was massive.

They weren't just a little bit off the mark—they were dead wrong. Even since the deficit-reduction package passed, more than 10.5 million new jobs have been created (93% of them in the private sector), the deficit has been cut in half, and interest rates are at the lowest level since 1968.

Conservatives are fond of criticizing liberals for rewriting history. Maybe instead of pointing their fingers, they should be pointing their thumbs—at themselves.

J. Scott Gaillard
Vice-President

Duval County Young Democrats
Jacksonville, FL

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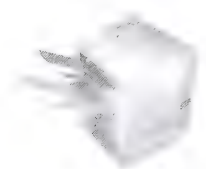
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ONE BEST WAY

Frederick Winslow Taylor and the Enigma of Efficiency

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WORKINGMAN'S HERO OR FAT CAT'S FRIEND?

He was wealthy and privileged, born into a Philadelphia family where gentlemen didn't work and where a proper education included several years of traveling and living in Europe. His boyhood hobby was collecting birds' eggs—he had 800 of them. He was a top-ranked tennis player at the Young America Cricket Club, and his first patent was for a spoon-shaped tennis racket. His school was Exeter, from which he was expected to move on to Harvard. Of medium build with a blond mustache and piercing eyes, Frederick Winslow Taylor was well on his way to becoming just another toff from Philadelphia's elite Main Line.

At 18, he broke rank. Dropping out of Exeter with severe headaches from eyestrain, he apprenticed himself at the enterprise Hydraulic Works, a steam-pump maker in Philadelphia owned by family friends. The opportunity changed his life, and with it, the entire practice of work. "Taylorism," as every student of late 19th century history learns, turned craft work into assembly line work. It presaged automation and the machine age, gave us speedups, downings, and rules for every job. For Taylor haters, it turned workers into robots, mechanized production, gave rise to trade unions, and replaced judgment with the time clock and stop watch. It ripped the workingman of his dignity. Or did it? As Robert Kanigel recounts in this marvelously done biography, *The One Best Way: Frederick Winslow Taylor and the Enigma of Efficiency*, perhaps no character in modern business history inspired such strongly held views and left such a legacy. Taylor believed there was one recipe for every task, from shoveling coal to pouring steel. To his supporters—and he had many on the left as well as the right—he was a liberator who got working men and women higher wages by ap-

plying scientific methods to the dangerous factory floor. Work better for more pay was his credo. To management, he was a dangerous radical intent on upsetting the equilibrium of the factory—low wages for low output. That there were no moderate opinions of Taylor had to do with his own temperament. "A man of immense spirit, intelligence and tenacity, he managed to alienate, or at least irritate, almost everyone, including many of his own circle of admirers. He was irascible, hard-cussing, forever landing in trouble," writes Kanigel.

A crusade such as Taylor's to bring scientific management to the workplace would have happened at some point anyway. Rational inquiry into all aspects of life was underway, and organizing work was a necessary precursor for all the automation and modern factory practices that followed it. Nor was Taylor possessed of original insights. His forte was rationalizing ideas. "He took fragments of thought and practice and directed them down one tight channel, focused them, packaged them as a single item, and projected it into the twentieth century," notes Kanigel. He was an acute observer. As a boy, he kept detailed journals of his time. As a teenager, traveling through Europe by private coach and train, he graded the Swiss hotels he stayed at by quality and price. Viewing an Austrian salt mine, he made detailed notes about inefficient procedures. By the time he hit the pump factory, he seemed almost predestined to become America's first management consultant.

What was remarkable, though, was his messianic zeal. For 30 years, Taylor barnstormed the country preaching sci-

entific management. He shuttled by train between Maine and Wisconsin, trying to bend factories to his methods. He bet his own money on ventures and lost big, although he later made millions from royalties, patents, and fees. He delivered hundreds of lectures and wrote dozens of articles. In his last years, businessmen vied to attend lectures at Boxly, his Philadelphia estate.

Taylor was 54 when fame struck. Boston lawyer Louis Brandeis, soon to become a Supreme Court Justice, successfully used Taylor's theories to block America's railroads from getting a rate increase. Brandeis said the carriers could offset their rising costs with more widespread use of Taylor's efficiency methods. The federal government agreed. The rail barons were furious, the public delighted.

Numerous historians, psychologists, and polemicists have asked, as Kanigel does: "How did a man who need never work at all, and who actually disdained

manual labor, throw himself onto the shop floor, confront what was arguably the thorniest social problem of his day, and devote his life to creating what he conceived as an industrial utopia?"

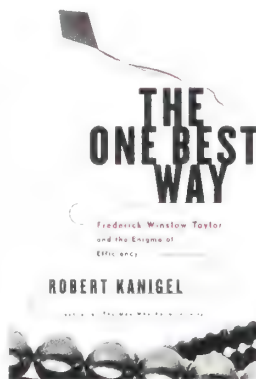
Some saw him rebelling against his father's lassitude. Others suggested the influence of a dominant Quaker mother. Muckrakers such as Ida Tarbell backed him as a champion

of the worker. Lenin, Mussolini, and the Japanese all borrowed his ideas. Politicians called him depraved, but Taylor's real failing was tunnel vision. Hauled before Congress in 1912 to defend himself, he was unable to explain how his system might benefit workers beyond a fatter paycheck. He died three years later at 59, depressed and bewildered.

Today, with fads such as empowerment and reengineering changing the workplace, Kanigel doesn't have to debate Taylor's relevance. All he had to do was tell the clanging, hissing tale of the founder of one of the century's great "isms." I was sorry when it ended.

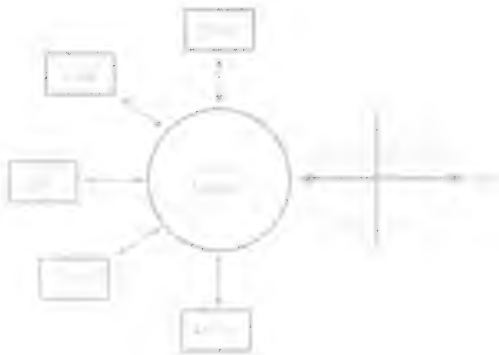
BY ROBERT DOWLING

Assistant Managing Editor Dowling once had a job buffing flatware on a Taylorite assembly line.



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BY STEPHEN H. WILDSTROM

TEST-FLYING THE NEW PILOT

It's still an ace palmtop computer, but a less-than-great communicator

In the year or so since its introduction, the Palm Pilot has dominated the palmtop-computer market for a simple reason: It doesn't try to do very much, but it does its limited tasks very, very well. The new version of the Pilot, made by the Palm Computing Div. of 3Com (800 881-7256), branches out a bit. The good news is that it is better than ever at its core tasks of giving you an easily portable copy of your computerized address book, calendar, and to-do list. But many of its added functions, especially the ability to send and receive E-mail, are disappointing.

The Pilot comes in two versions, the \$299 personal edition, with 512 kilobytes of memory, and the \$399 professional version, with twice as much memory and E-mail capability. The most important addition to the six-ounce, credit-card-size unit is backlighting, which makes it easy to read under less-than-ideal lighting conditions.

ANYONE HOME? Another advance is an optional \$129 modem that adds three inches in weight and two inches in length when it snaps on to the bottom of the Pilot. New communications functions include the ability to synchronize data with a desktop information manager over a direct modem connection. The professional version can also handle a local-area network or

the Internet and deal with various E-mail systems, whether they're standard Web programs or proprietary programs, such as Lotus cc:Mail.

The direct-modem connection works as well as Pilot's famously simple desktop method of setting the unit in a cradle and pushing the sync button. But there's one important caveat: Your desktop machine has to be up and running or you can't connect. If your desktop is



a corporate computer, you'll probably find that leaving your computer on is discouraged, if not prohibited, as a serious security risk.

The same problem also limits the usefulness of "network hot sync," a \$69 software option. And there's an additional complication: Even though Palm has gone to some lengths to make it easy to get your Pilot to work over a network, not

even Palm can tame a network. Most Pilot owners are going to need help from network administrators to get this feature working.

The problems of E-mail are inherent in the nature of the Pilot. Limited memory precludes downloading file attachments, and the diminutive screen makes it tough to read all but the shortest of messages.

Writing mail is worse. The Pilot offers a choice between tapping a tiny on-screen keyboard or, as most users prefer, writing in a shorthand called Graffiti. This is fine for entering an appointment or a to-do item, but it's a tedious way to write messages. The Pilot offers a handy means of scanning urgent messages and sending brief replies, but it's hardly a replacement for a laptop when it comes to handling mail on the run.

LIBRARY. Some of the new software touches, such as an expense-tracker that can transfer data to a Microsoft Excel spreadsheet, are handy. And there is a growing library of third-party applications available,

CLICK HERE: *The optional, snap-on modem is easy to use*

including links to a variety of desktop contact managers and scheduling programs.

Pilot's success has inspired imitators. Sharp's \$299 SE-500, scheduled for release later this summer, is a bit larger than the Pilot but has a built-in modem. And this fall, look for a device no bigger than a credit card that can download your computer address book and calendar. Pilot, however, is the model to beat. I've tried a variety of palmtops, and Pilot is the one that has earned a place in my pocket.

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FOLLOW-UP

SCHOOLS AND THE NET

The column "Readin', Writin', and the Internet" in the June 9 issue brought forth an outpouring of interest from readers.

Teachers wrote about their successes and frustrations in integrating technology into classes, parents wrote about their concerns, and a variety of businesses and nonprofit organizations offered assistance. To get those who need help in touch with those who can provide it, BUSINESS WEEK has set up a Technology & Education moderated E-mail discussion group, available free to anyone interested. To subscribe, just send a message to listserv@ftp.mcgraw-hill.com with the message "subscribe tech-ed." Archives of the group will be available at www.businessweek.com.

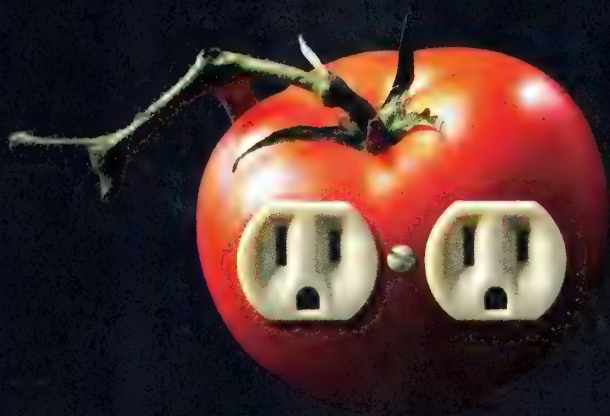


SOFTWARE

TRICKS WITH TRACKS

Mixman, from Mixman Technologies (415 403-1380) is one of the more unusual, and certainly one of the noisiest, pieces of entertainment software to come my way. The \$30 program offers an on-screen audio mixer that lets you combine individual audio tracks on the included recordings any way you want—adding bass here, taking out percussion there. You can save your fantasy remix to disk for future playback. Mixman comes in two versions—one featuring a variety of hip-hop and dance music, the other the funk rock of recent Rock and Roll Hall of Fame inductee George Clinton.





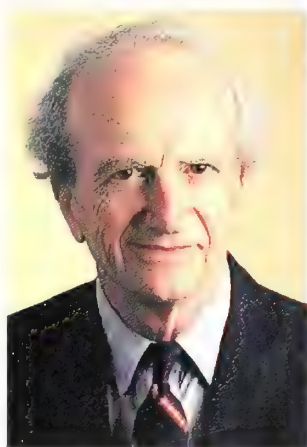
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BY GARY S. BECKER

DON'T BLAME HIGH TECH FOR EUROPE'S JOB WOES



LOOSEN UP:
Plain old government meddling—like regulations and taxes—is what makes businesses loath to hire. But that's easily fixed

I recently returned from a lecture trip to several Western European nations, where the two main topics were the causes and cures of their high unemployment, which has averaged over 11% for several years, and the plans for a common currency. These are closely related subjects since a new currency probably will not be introduced in 1999, as scheduled, unless the unemployment situation greatly improves.

The great concern about unemployment helps explain the astounding victory of the Socialists in the recent French national elections over Jacques Chirac's do-nothing government of the right. They promised to create jobs by slowing down privatization and by legislating reduction of the workweek to 35 hours or less to encourage job sharing.

But such make-work programs have always failed to stimulate private employment since they raise the cost of labor. This has recently been shown in a study of the German experience during the past decade by economist Jennifer Hunt of Yale University. She finds that government and union pressure there to reduce the standard workweek may actually have reduced overall employment.

FLUX. Many European politicians and some intellectuals are suggesting work-sharing because they have been convinced by recent claims that the number of possible jobs in a market economy is shrinking because of computers and other technological advances that reduce the need for workers. Such advances have always caused apprehension about job losses. Just recall the Luddites' attempt to protect their jobs by destroying new textile manufacturing machinery in the 19th century. However, in the past, many workers found employment in industries created by new technologies, such as textile manufacturing, automobile production, airline travel, and steel production. As a result, overall unemployment rates in Europe and the U.S. did not grow during the past 150 years.

Similarly, computers and other products have stimulated robust demand for workers in many newly created sectors, including chip-making, telecommunications, software programming, biotechnical products, and other advanced businesses. Despite the fear-mongers' warnings, there is no evidence that recent technological advances have much to do with the high unemployment rates found throughout Europe. Indeed, there is no evi-

dence that recent advances have been faster than those in the past.

No, the employment problems of France, Germany, Italy, Spain, and elsewhere in Europe are due more to conventional interventions in labor markets that discourage companies from hiring workers. These include very high social security and other taxes on labor, generous subsidies to persons with jobs that discourage them from looking for work, and onerous regulations that raise the difficulty and cost of hiring and firing workers. Italian owners of small and midsize businesses told me that union and government regulations make it virtually impossible to hire workers when times are bad. And the situation isn't much better in the other countries.

LONG HAUL. Many regulations also discourage young entrepreneurs from starting new enterprises that have been so important to job creation in the U.S. In Italy, it takes three to five years to get all the approvals for a new business, unless officials are bribed to speed up the process.

Labor-market reforms in Britain are a good example of how to reduce Europe's unemployment. Britain lowered labor taxes and regulations and greatly weakened the economic and political power of large national unions. The effect was a rapid expansion of private employment and a reduction of overall unemployment to under 6%.

The relatively flexible labor markets of the U.S. have created jobs at an impressive rate since the early 1980s. Almost 70% of men and women of working age are employed in the private sector, and unemployment has dipped to below 5%. Western Europe, by contrast, has experienced no net increase in private employment since the middle of the 1970s. Western European companies now resist lower labor taxes and greater employment flexibility if they are to hire additional workers in Europe rather than setting up plants abroad.

To effectively deal with the continent's sluggish job creation, European governments must take action by cutting taxes, subsidies, regulations, and controls over employment, wages, and new businesses. That would provide new jobs and raise output. And it would help the unemployed boost their self-respect by allowing them to help create national wealth instead of depending on government handouts.

Gary S. Becker, the 1992 Nobel laureate, teaches at the University of Chicago and is a Fellow of the Hoover Institution

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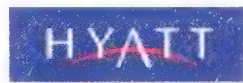
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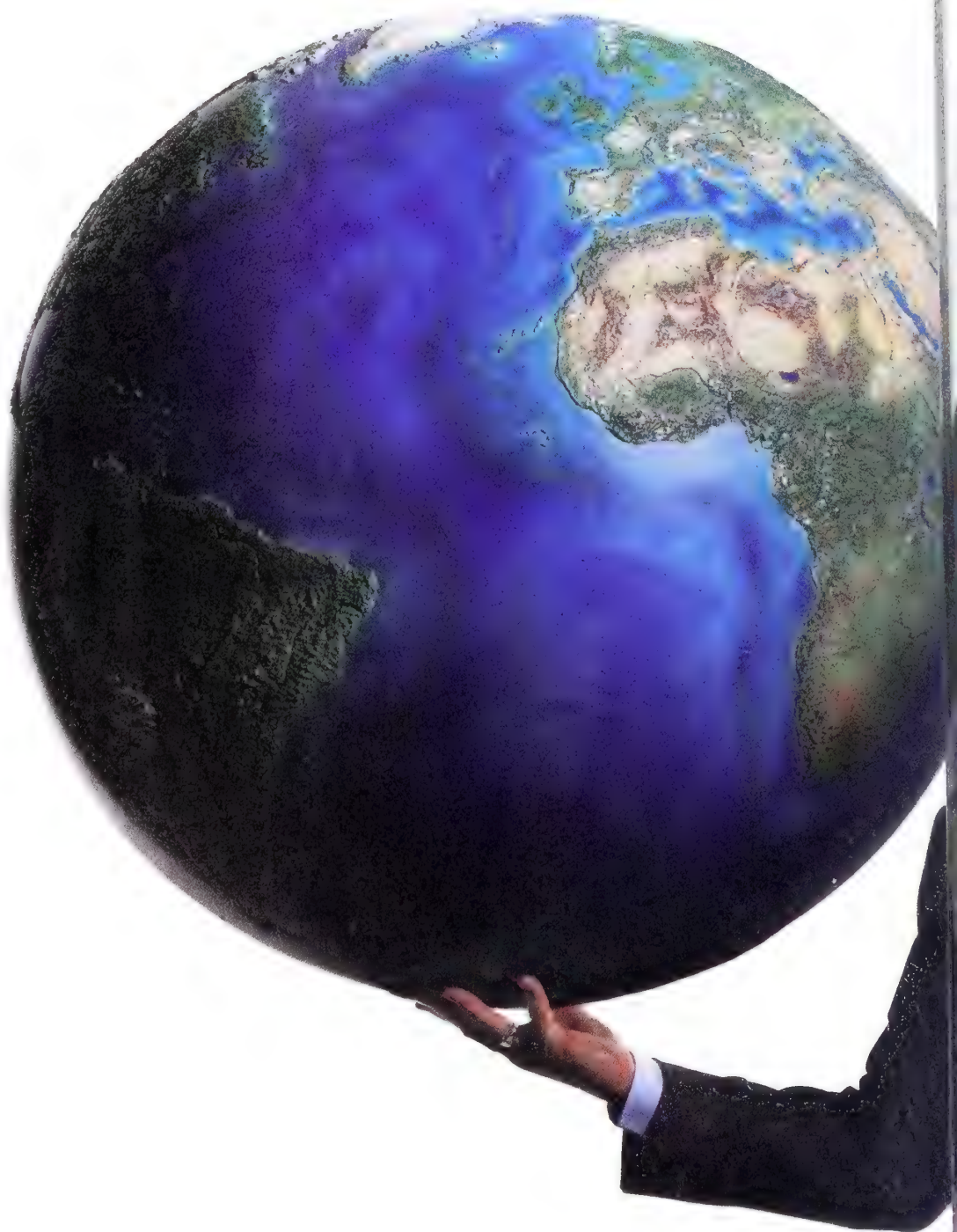
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Transactions in the Age of the Consumer

Greg Meekings, Managing Director,
Corporate Technology Group, Reuters.

BY GENE KORETZ

BIAS STILL BLOCKS BLACK PROGRESS

Why lawmakers should take heed

There's no gainsaying the wide socioeconomic gulf that still separates blacks and whites in America, and particularly the entrenched poverty and crime that afflict urban ghettos. There is also no denying the substantial progress made by a significant minority of blacks in recent decades, and the rise of a vibrant, successful black middle class.

Looking at this picture, many Americans have concluded that racial discrimination in hiring is no longer a major problem in the U.S. Rather than



GREAT DIVIDE: Recent studies point to the insidious effects of racism

stressing affirmative-action programs and anti-bias statutes, they say, public policy should now focus on enabling blacks to move ahead by providing better education, job training, tax benefits, and entrepreneurial incentives.

It's a strong argument, and such steps are clearly desirable. But several recent studies suggest that racism is far more prevalent in American life than advocates of a public policy shift realize.

In a survey of 3,000 companies in four major U.S. cities with sizable black populations, economist Harry J. Holzer of Michigan State University found that small businesses were far less likely to hire blacks than larger companies. Among companies with fewer than 50 employees, blacks held only 13% of jobs requiring less than a college degree. In companies with more than 500 employees, blacks held 26% of such jobs.

Even after considering a number of factors (such as site location and the lack of formal hiring procedures) that tend to limit employment of blacks by small businesses, Holzer finds that job discrimination appears to be "much more pervasive in smaller establishments than larger ones."

Perhaps more troubling are the implications of a recent National Bureau of Economic Research study by economists Alberto Alesina, Reza Baqir, and William Easterly. Analyzing Census Bureau data for U.S. cities in the early 1990s, the researchers looked at how ethnic diversity affected local spending on productive public goods, such as education, roads, and sewers.

The findings were revealing. Other things being equal, more racially or ethnically diverse cities—in most cases, with a white majority and black minority—spent less of their budgets and less per capita on education, roads, libraries, sewers, trash removal, and even welfare than cities with more homogenous populations. This was true even though state and federal transfers augmented local outlays on welfare and education.

The researchers conclude that majority white voters (or any ethnic or racial majority) tend to spend less on public goods when a sizable fraction of their taxes are used to provide public goods shared with other racial or ethnic groups.

Such studies suggest that solving the nation's problems of race and poverty will not be easy. Small business accounts for over half of U.S. employment and much of recent job creation. Devolution of welfare and other federal programs to local control could result in even lower public investment in hard-pressed areas—investment essential to ensuring black and minority progress.

BOND SPREADS ARE SHRINKING

Credit the low-inflation expansion

Has speculative exuberance invaded credit markets? Looking at bond-yield spreads, you might think so. While the spread between high-grade corporate bonds and super-safe U.S. Treasuries has hardly changed over the past year—or the past decade—the spread between high- and low-grade corporates has narrowed appreciably.

Such spreads tend to widen as a recession nears, as the double whammy of rising rates and a weakening economy raises the risk of business failures. The fact that they are so narrow now, says economist Ram Bhagavatula of Citibank, is a direct result of the current low-inflation, strong-growth environment. The Fed's preemptive attacks on inflation earlier in the cycle have reduced the chances of a sharp recession-inducing round of tightening anytime soon. And

low inflation makes it easier for companies to avoid inventory excesses.

Thus, reduced risks of policy-induced recessions and production excesses have lowered the chances of default by weaker companies and the interest premiums on their bonds. Even when a downturn finally occurs, says Bhagavatula, could prove to be more muted than the past—resulting in a less dramatic widening of credit spreads.

MORE PROFIT FROM LESS CARE

Health costs drop—for employer

While employers' health-insurance costs have been falling sharply during the 1990s, many experts believe that much of the slowdown reflects a one-time shift from fee-for-service plans in which patients chose their doctors to thriftier managed-care plans. Once this transition for the bulk of the workforce is completed, say the experts, costs will start rising sharply again.

Economists Alan B. Krueger and Helen Levy of Princeton University are so sure. In a recent study, they find that employer costs have waned because of several developments: a steady decrease in the fraction of workers with coverage, a big slowdown in the growth of insurance premiums for both fee-for-service and managed-care plans, and a modest shifting of premium costs from employers to employees.

Looking ahead, the researchers think the slowdown in employer outlays may well persist. The fact that premiums for fee-for-service as well as for managed-care plans have decelerated suggests that underlying factors (possibly heightened competition and/or reduced benefits) are restraining costs. And the erosion of coverage, particularly among less-skilled workers, is continuing.

Of course, these trends are not necessarily good news for workers. Besides losing coverage entirely or picking up more of the tab for premiums, many employees may also be facing higher deductibles and coinsurance payments or lower benefit packages.

A PLUMMETING TAB FOR HEALTH CARE



JAMES C. COOPER & KATHLEEN MADIGAN

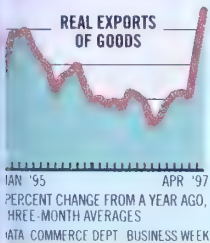
SUMMER'S PLEASANT SURPRISE: IZZLING EXPORTS

Growth in key U. S. markets is looking better and better

U.S. ECONOMY

That ray of sunshine starting to emerge from the U. S. trade balance is coming from exports. After languishing at a single-digit growth rate for most of last year, shipments headed overseas are surging once again. Stronger foreign demand for aircraft, machinery, and consumer wares is being fueled by improving growth abroad that more than offsets any loss of competitiveness suffered from last year's rise in the dollar. The new energy in exports means that trade is helping to be less of a drag on U. S. growth this year than previously expected. In the second quarter, for example, stronger foreign demand is a key reason why manufacturing orders and output remain so buoyant, despite the slowdown in U. S. consumer spending. Exports continue to pour ashore, but unlike last year, imports will provide a buffer against any further deterioration in the trade deficit.

SHIPMENTS ABROAD ARE PICKING UP STEAM



Imports posted a bigger gain, however, rising to \$17.7 billion with growth dominated by apparel, toys, and sporting goods. The pause in consumer spending means that some second-quarter easing in import growth is likely, but any slowdown in the demand for foreign goods will not last. Domestic demand appears to rebound in the second half, especially given the most exuberant readings on consumer confidence.

THE BIG NEWS

from the trade front is exports. Although foreign demand for services is picking up, the steepest acceleration has been in exports of goods (partly). Adjusted for inflation, shipments over the past three months are up 16% from the same period a year ago, the fastest such pace of this six-year expansion. What goods are feeding the export revival? Not the usual suspects of farm products and computers. In fact, exports of agricultural goods have been falling

sharply since the end of last year. And while shipments of high-tech goods are growing at double-digit rates, the acceleration of low-tech capital equipment, such as industrial machinery, is more impressive. After posting negative growth rates in mid-1996, these exports have come roaring back so that in the last three months, low-tech exports have been growing slightly faster than their high-tech counterparts.

Increased shipments of textiles and pharmaceuticals have helped push the growth rate for consumer-goods exports back into double-digit territory, as well. Also, car exports have picked up, rising 22% in the 12 months ended in March and April. That strength reflects robust demand from car buyers in Mexico and Canada, which is helping to buoy the third-quarter outlook for U. S. auto production.

Despite auto strikes this spring, which depressed overall orders and output in manufacturing, exports are helping to keep orders on a rising trend. Although bookings for durable goods fell 0.6% in May, orders excluding transportation equipment rose slightly, and because of a strong April increase, the quarterly average is running well above that of the first quarter.

THE LATEST EXPORT DATA

are cheerier than economists expected in late 1996. Back then, the strengthening dollar and the gloomy outlooks for Europe and Japan cast a pall over prospects for exports in 1997. However, growth in key U. S. markets is now looking decidedly upbeat, especially close to home (table).

Exports to both Canada and Mexico, which account for 33% of U. S. goods shipments, have accelerated sharply during the past year, as have exports to most Latin American ports. Mexico's economy, rebounding from its 1995 peso crisis, grew 5% last year, and 4% growth is generally expected for 1997. Growth in Canada, also expected to approach 4% this year, is likely to be the fastest of the major industrialized countries.

The biggest surprise, however, is Europe. The British economy's strength will last, and while growth on the Continent has been held back by the fiscal restraint re-

WHERE U.S. EXPORTS ARE STRENGTHENING

EXPORT SHARE	DESTINATION	EXPORT GROWTH* '96	'97
24%	W. EUROPE	8.9%	10.2%
23	CANADA	4.8	12.4
19	PACIFIC RIM**	10.1	2.1
10	MEXICO	15.9	23.4
10	JAPAN	12.8	-3.4
8	S. AMERICA	5.1	26.2
6	REST OF WORLD	15.5	15.2

*JAN. TO APR. VS. SAME PERIOD A YEAR EARLIER
**EXCLUDES JAPAN

DATA: COMMERCE DEPT., BUSINESS WEEK

quired for the move toward a single currency, industrial activity is picking up, as is business investment, and thus demand for capital goods. In the final four months of 1996, U.S. exports to Western Europe had grown only 1% above the year-earlier level. But in the first four months of 1997, annual growth shot up to 10.2%.

The current weak spots in the export picture are Japan and the Pacific Rim generally, where various problems involving currency weakness, capital flight, and banking-system woes have curbed demand. U.S. exports to Japan are actually falling. Domestic demand in Japan is currently stifled by a round of higher taxes, as the country tries to rein in its past fiscal excesses.

IMPORTS, HOWEVER, WILL REMAIN the blight on the U.S. trade horizon. Real exports may be up a stellar 16% from a year ago, but imports match that pace, and they're about one-fourth larger than exports.

Surging imports have a bright side, though. The strongest anti-inflation force at work this past year has been import-price deflation. The flood of imports, which account for one-fourth of all nonoil goods bought in the U.S., has been abetted by the dollar's two-year rise. That helped push nonoil import prices down by 3.3%, and cheap imports deter U.S. producers from hiking prices. But with the dollar's rise now over, those inflation checks won't be as strong in the second half.

Looking ahead, import growth will remain strong

because consumers believe more and more in this expansion's ability to generate job opportunities and bigger paychecks. And that confidence is leading to bounceback in household spending.

The Conference Board's index of consumer confidence jumped to 129.6 in June, on top of a stunning nine-point increase in May, to 127.9. Confidence is at its highest since August, 1969. Although the soaring stock market is partly responsible for the upbeat mood, jobs seem to be the primary catalyst. The Board reports that 36% of households consider jobs plentiful, while only 16.5% think they are hard to get (chart). Those two readings indicate that consumers think this is the tightest labor market in 28 years.

The return of the consumer will likely be the keynote of the third-quarter economic data. But the changing trade outlook should not be ignored. Rising domestic demand means that imports—and their deflationary pressures—will not go away. And the sunny outlook for exports means that U.S. manufacturers will be able to keep their factories going full-tilt, providing gains in output and payrolls in the second half.

CONSUMERS SEE A VERY TIGHT JOB MARKET



JAPAN

BUSINESSES STILL SEE A FRAIL RECOVERY

Japan's most comprehensive and closely followed economic report indicates that the recovery remains fragile, especially for small businesses, the country's major employers.

The June 25 Bank of Japan's quarterly *Tankan Survey* showed diverging outlooks from manufacturers and service companies. The top-line sentiment index for large manufacturers rose to 7 from 2 in the first quarter, meaning optimists outnumbered those expecting growth to slow. But the worries of smaller non-manufacturers are mounting (chart). The gulf is also evident in expectations for the economy and for capital spending plans.

Construction companies have taken a big hit because of Japan's weak housing sector and the cuts to public-works spending initiated by Tokyo to close the widening budget gap. In addition, service

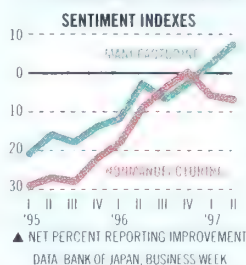
companies including distributors and retailers are hurting from a weak consumer sector. They are also being squeezed by large manufacturers who must cut costs to compete globally.

Preceding the *Tankan* by about a week was the Ministry of Finance's business sentiment index survey. The BSI showed a steep drop in businesses' view of current economic conditions. However, the BSI survey also said that

companies expected a pickup in the third-quarter economy. That suggests that the Apr. 1 hike in the value-added tax is only temporarily hurting spending.

One reason for the split in confidence reflected in the *Tankan* is that exports of large manufacturers are booming, thanks to the weak yen. In May, exports surged a surprising 20.5% from a year ago, while slow domestic demand meant that imports rose just 6%. As a result, the trade surplus soared to 738 billion yen (\$6.4 billion) in May, from 229 billion yen a year earlier. The vast widening in the trade surplus already has spurred new trade tension between Japan and the U.S. That's unlikely to go away, especially since the *Tankan* shows that businesses still seem to see only slow growth prospects at home.

TANKAN SURVEY SHOWS DIVERGING OUTLOOKS



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NOT SO FAST

The tobacco deal, under heavy fire, is likely to undergo major changes. How much tinkering can it take before it comes apart?

It could be the Settlement of the Century. After three months of tense, delicate negotiations, a group of attorneys general and lawyers for Big Tobacco have struck a deal of historic proportions: The cigarette companies would ante up \$368 billion over 25 years to settle lawsuits against them, submit to Food & Drug Administration regulation, and meet strict goals for reducing smoking in the U.S. By 2022, tobacco's role in American society would be forever reduced.

But don't rewrite the history books just yet. The stunning, 68-page pact reached on June 20 marks the beginning of a new round of bitter, protracted battles. As Congress and the Clinton Administration ponder the details and test the political winds, two questions are emerging: Can the deal be improved? And how much tinkering can it withstand before it falls apart?

The answers—now being voiced from

Capitol Hill to the White House to the boardrooms of leading public-health groups—are “yes” and “a lot.” Says Frank J. Lautenberg (D-N.J.): “If the tobacco companies think Congress is going to rubber-stamp this agreement, I have one question for them: ‘What are you smoking?’”

Indeed, as people who weren't in on the deal read the fine print, a growing consensus is forming that it doesn't go nearly far enough in regulating the industry and cutting smoking in America.

On June 25, a preliminary report released by a high-powered advisory committee chaired by former FDA chief David A. Kessler and former Surgeon General C. Everett Koop outlining seven major objections to the proposed deal. The Administration's initial conclusion is that key provisions are waffling, and President Clinton's advisers believe the companies can be pushed to accept harsher conditions and penalties.

That's not good news for tobacco executives, who are already pleading hard-



Senior Clinton aides expect some form of legislation to be enacted—but they say he won't sign a pact that is shunned by the health community

After the Smoke Clears

How Health Groups Hope to Change the Terms

SETTLEMENT TERMS

PRICE

Cost per pack would jump by more than 50¢ to offset industry's settlement costs. No new taxes imposed.

NICOTINE REGULATION

FDA must jump through formidable new legal hoops to regulate nicotine now—and wait 12 years to ban it.

MARKETING RESTRICTIONS

No more ads outdoors or on the Internet, or product placement in movies or TV shows. A ban on human or cartoon figures in ads.

PUNITIVE DAMAGES

In return for a ban on punitive damages, the industry will pay \$60 billion.

ANNUAL PAYMENTS

Proponents claim the industry will fork out \$368 billion over the next 25 years.

HEALTH ADVOCATES' POSITION

Suggesting a \$2-per-pack price increase through a combination of taxes and other means.

FDA should retain current power to regulate nicotine levels, as well as all of its current regulatory authority.

A total ban on cigarette marketing and advertising.



KESSLER AND KOOP CONFER

Victims of smoking should surrender none of their rights to sue for punitive damages.

Most take no position, but some attorneys general want higher payments.



ATTORNEYS GENERAL AT THE ANNOUNCEMENT

And the health advocates have

reason to bend, not break, the agreement. With a settlement, the public-health community would get more weapons in the war against smoking than they dared dream of a few short months ago. "It would be a shame right now if the settlement was condemned and dismissed without the opportunity to work with all sides to get the best agreement," says Marilyn Hunn, chairman of the board of directors of the American Heart Assn.

How will a deal emerge? Part of the answer depends on how skillfully the anti-smoking and public-health forces play their hand. Many prominent players, including Matthew Myers of the National Center for Tobacco-Free Kids, who was the top public-health advocate in the negotiations, are also members of the Kessler-Koop group. But a strong faction in the health community contin-

Domestic Policy Council Chairman Bruce Reed, who's co-heading the Administration's review of the settlement with Health Secretary Donna E. Shalala. Even the most vocal tobacco foes in Congress are trying to find something to like in the deal as it has been proposed. "There are a lot of good things in the settlement," says Representative Henry A. Waxman (D-Calif.), a leading anti-smoking lawmaker.

LAWYER WINDFALL. There are other forces pushing for a deal. States stand to get billions of dollars in tobacco-industry payments if the deal stands as is. And the powerful trial lawyers would get the largest fees in history to settle the class-action suits against the companies. "Wall Street, the President, the attorneys general, and the cigarette companies all want a deal," worries Julia Carol, co-director of Americans for Nonsmokers' Rights, a vocal critic of the deal. "Those are some pretty damn powerful forces."

the current proposal. Indeed, as Kessler-Koop panel outlined their terms, Philip Morris Cos.' stock price fell, to 43% a share.

There are plenty of reasons to think that a tobacco deal—in some form—will survive. Most players in this game have compelling reasons to want a deal enacted by Congress. For regulated companies, it means an end to the dark cloud of litigation hanging over their heads—and a chance to reinvent themselves (page 36). That prospect has lifted tobacco stocks since the talks began.

The White House has a lot invested in tobacco, too. The Administration may have reservations about details of the proposal, but President Clinton badly wants the kudos for winning a battle against tobacco—and smoking—that his Administration started. "We're determined to make sure that something good comes out of this whole effort," says White House

ues to oppose any settlement at all. Activists such as Roman Bowser, executive vice-president of American Heart's California affiliate, argue that they're winning the fight against tobacco already—and don't need a settlement with loopholes the industry can exploit.

Even tobacco's supporters in Congress are conceding that opposition by the likes of Kessler and Koop means that the deal in its current form, cannot work. "This will never see the light of day," says a key GOP Hill staffer. "Either it dies up here, or it gets so changed it won't be recognizable."

So what are the most likely changes? For starters, FDA regulation. The accord gives the agency the power to regulate nicotine and other ingredients in cigarettes—though the agency can't eliminate the drug entirely for the next 12 years. But the language of the settlement makes it almost impossible for the



Tobacco's supporters recognize the clout of Kessler and Koop. "This will never see the light of day," says a key GOP Hill staffer. "Either it dies up here or it gets so changed it won't be recognizable"

HEALTH SECRETARY SHALALA (ABOVE) AND DOMESTIC POLICY CHIEF REED ARE LEADING A TEAM THAT IS REVIEWING THE DEAL FOR THE WHITE HOUSE

agency to do its job. Before it can regulate nicotine, the FDA would have to prove that cutting nicotine levels will reduce the health risks of smoking, that such steps are technologically possible, and that the result won't be a black mar-

ket. The deal also requires the FDA to do all this using a cumbersome rule-making procedure that takes years to complete. FDA officials have been asked not to comment until the team led by Shalala and Reed finish their review in a

HOW BADLY IS LIGGETT GETTING BURNED?

In March, Mississippi Attorney General Michael Moore and 21 of his colleagues struck a bargain with Bennett S. LeBow, chairman of the parent of tiny tobacco company Liggett Group Inc.: If he turned over long-sought, potentially incriminating documents on the cigarette industry, they would cut him a deal. LeBow provided fodder that helped bring Big Tobacco to the bargaining table.

Now, industry leaders have signed a historic agreement with 40 state attorneys general. And LeBow? His deal seems to be going up in smoke. It turns out that while the cigarette companies were negotiating with the AGs, they found a way to get even with LeBow. Now, Liggett—with less than 2% of market share—stands to fare the worst among tobacco companies.

Time and again, the tobacco firms rejected entreaties to exempt Liggett from the financial assessments based on market share, which make up the \$368.5 billion industry payment over 25 years in the proposed settlement. "At every meeting we demand-

ed that, and at every meeting they opposed it," said Moore. "As you can imagine, he has made them very mad."

LeBow sent a letter to more than 20 attorneys general on June 24 saying he was "outraged" by the terms of the global tobacco deal and its failure to protect Liggett's original settlement. Says Marc E. Kasowitz, the attorney who represented Liggett in its settle-

ment: "We can't agree to this deal because it puts us out of business." Liggett's already on the verge of bankruptcy. If it can't restructure \$145 million in debt due in 1998 and 1999, it could face bankruptcy. Meanwhile, Liggett is still battling other companies in court over the release of documents it promised in the deal, when it waived some of

attorney-client privilege. The proposed settlement does not require that tobacco companies

Liggett had a deal in March. He agreed to turn over pretax documents over the years into a big consideration. Liggett's stock price dropped in 1996. In June, Liggett would pay up to 15% of its share. Even less than that share, the amount amounts to a million—

Different Deals

WHAT LIGGETT GOT

Liggett must pay 25% of pretax earnings over 25 years.

Cigarette packages must carry a warning that smoking is addictive.

Must turn over documents that will help in lawsuits against the cigarette industry; waives attorney-client privilege.

Bennett LeBow agreed to make a personal declaration that smoking causes lung cancer and that cigarette companies do market to youths.

THE PROPOSED GLOBAL SETTLEMENT

Signing tobacco companies will pay \$368.5 billion over 25 years. Non-participating manufacturers must reserve in escrow fund 150% of share of annual payment.

All cigarette and smokeless tobacco packages must carry blunt warnings about health effects.

Documents that would have been revealed through litigation will be public; no waiver of attorney-client privilege.

Tobacco companies acknowledge the dangers of tobacco.

or so. But privately, they're aghast. The provisions that tie the agency's hands, they contend, are evidence of how the attorneys general got snookered by tobacco lawyers. The White House has already gotten the message. One of the key questions, says Reed, "is the FDA's ability to do its job."

Another area where the White House and congressional public-health defenders are expected to demand changes involves the goals for cutting youth smoking—and the penalties assessed to companies for not meeting them. The deal calls for a 30% reduction in kids' smoking in five years and 60% in 10 years. Companies get hit with an \$80 million penalty for every percentage point short of the goal. But the industry can get much of that back if it shows good faith efforts in meeting the goal. Even provisions that purport to be good, such as this penalty thing, come

with ridiculous conditions," fumes an Administration official. That's why the Kessler-Koop panel is insisting on a 15% cut by the second year, increasing to 65% by year 10. It also wants far larger penalties that the industry can't avoid.

DIRTY SECRETS. Meanwhile, a group of renegade state attorneys general is also clamoring for changes. Their leader, Minnesota's Hubert H. Humphrey III, has a list of objections that include the deal's provisions for keeping industry documents secret, for limits on industry liability, and the terms of the financial payout. "The money does not cover the harm that this industry has done," he argues. Douglas Blanke, one of Humphrey's assistant attorneys general, says disclosing industry documents would bolster public-health advocates' arguments for a tougher deal. "Are there smoking guns in there? There are smoking howitzers," he says.

How far will the industry bend to satisfy all these new demands? Despite repeated requests for comment, company execs are remaining mum. But T. Rowe Price Associates Inc. analyst Arthur B. Cecil is pessimistic about the industry's chances of getting a settlement without paying a steeper price. "I think it's just going to get worse for them," he says.

He may be right. Early indications are that the industry will have to cough up more concessions to get this deal past Clinton and Congress. But having gone this far, it may be a cost Big Tobacco is willing to pay to remain a part—albeit a diminished part—of the American scene.

By John Carey in Washington and Mike France in New York, with Richard S. Dunham and Amy Borrus in Washington, and David Greising in Atlanta

sum given its financial state. In later, LeBow complained that other tobacco companies "would see their prices skyrocket, while Liggett, a company that got them to the point where they would be ruined."

uncertain whether Liggett will be allowed to participate in the settlement. For those shut-out companies, there is a penalty clause, requiring them to abide by the settlement's marketing restrictions and still hefty escrow payments over 35 years. Since Liggett has already signed an agreement with similar provisions, Kasowitz doesn't think the company should agree to another. "We're going to take all steps necessary to ensure that Liggett's binding agreement is protected," Kasowitz, who accuses the AGs of trying to protect the whistleblower who helped make their case.

"RED HERRING." The attorneys general say they had only agreed to use "best efforts" to make sure that the March 1997 settlement was upheld. Moore still praises LeBow for his "courage" and says the attorneys general will try to help him in Congress. The company, while, has hired its own lobbyist to defend its case.

The problem for Liggett is that courts and anti-tobacco forces don't seem to see it get a different deal—one that would allow it to sell cigarettes for less than its competitors. That could undermine the goal of reducing youth smoking, for example. Kasowitz concedes that argument is a "red herring."

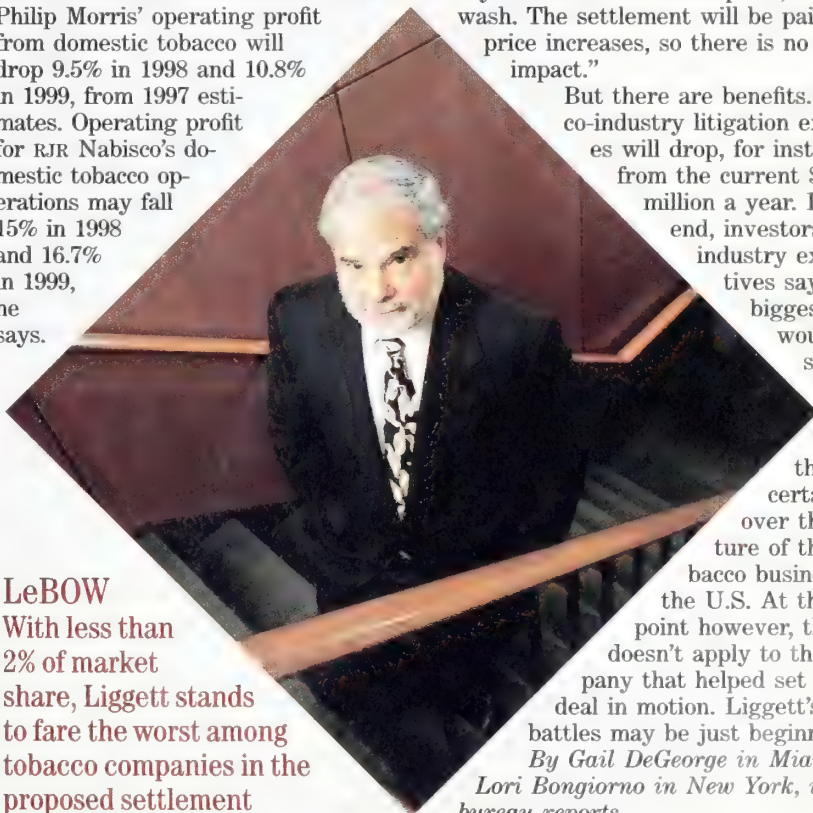
Of course, whatever tiny Liggett pays looks like a pittance compared with the numbers being kicked around for the majors. The current formula has Philip Morris Cos. shouldering about \$7 billion of the initial \$10 billion payout. That's about \$4 billion after taxes, says Smith Barney Inc. analyst Martin Feldman. He estimates that Philip Morris' operating profit from domestic tobacco will drop 9.5% in 1998 and 10.8% in 1999, from 1997 estimates. Operating profit for RJR Nabisco's domestic tobacco operations may fall 15% in 1998 and 16.7% in 1999, he says.

LeBOW
With less than 2% of market share, Liggett stands to fare the worst among tobacco companies in the proposed settlement

No U.S. tobacco company has a clear picture of post-deal profits yet. Feldman predicts a rise in prices to \$2.50 a pack from \$1.95, leading to a 10% drop in consumption the first year. But the settlement costs are tax-deductible business expenses. Sanford C. Bernstein & Co. analyst Gary Black says: "From a P&L standpoint, it's a wash. The settlement will be paid by price increases, so there is no real impact."

But there are benefits. Tobacco-industry litigation expenses will drop, for instance, from the current \$600 million a year. In the end, investors and industry executives say, the biggest plus would be simply removing the uncertainty over the future of the tobacco business in the U.S. At this point however, that doesn't apply to the company that helped set the deal in motion. Liggett's legal battles may be just beginning.

By Gail DeGeorge in Miami and Lori Bongiorno in New York, with bureau reports



COMMENTARY

By Paul Raeburn

AN UNHEALTHY DEAL WITH BIG TOBACCO

After years of taking aim at the tobacco Goliath, public-health researchers have a pretty good idea how to curb smoking. Unfortunately, lawyers don't.

That's the conclusion many public-health experts are coming to after examining the fine print in the tobacco deal announced on June 20. Most of them were not included in the negotiations, and they are now taking a hard look at the bottom line:

What does the deal mean for public health? The answer seems to be: not much.

"It's a pretty clear victory for the tobacco companies," says Stanton A. Glantz, a cardiology researcher and antismoking advocate at the University of California at San Francisco. He cites two worrisome provisions in the deal as proposed: The industry put potentially insurmountable roadblocks in the way of FDA regulation of nicotine and won the right to keep secret millions of pages of documents.

"FRAUD." In a court decision in North Carolina earlier this year, the FDA won blanket authority to regulate nicotine. But the settlement puts such severe limits on that authority that the FDA might never be able to act. "Whoever controls nicotine wins," says Douglas Blanke, an assistant attorney general in Minnesota.

The deal also aims to block release of 30 million pages of internal documents in Minnesota alone—documents that could turn public opinion even further against tobacco companies. "When the full extent of the fraud and conspiracy is generally known, the public and the Congress

will be less interested in givebacks to the industry," Blanke says.

These loopholes could disappear as Congress turns the proposed settlement into law. In the meantime, however, legislators should focus on how they can really improve public health. We now know which measures work and which don't. For example, in the early 1990s, California

tion of antismoking measures, says Michael P. Eriksen, director of the Surgeon General's Office on Smoking & Health (OSH). They included workplace and community education programs, public antismoking campaigns, and restrictions on access to tobacco. Another key was public approval, as expressed by passage of referendums to boost the taxes.

EDUCATION. Some solid antismoking measures are included in the proposed settlement. "It certainly is good to get tobacco out of sporting events and off billboards," says John R. Garrison, CEO of the American Lung Assn., although he rejects the settlement overall. Dudley Hafner, executive vice-president of the American Heart Assn., likes the curbs on marketing to teens, the anti-tobacco education campaign, and limits on secondhand smoke—but objects to tying the FDA's hands.

It's important, while evaluating the deal, to remember tobacco's toll. Smoking claimed an average of 430,700 American lives per year from 1990 to 1994. Smoking causes heart disease and cancer of the lung, larynx, mouth, esophagus, and bladder, and contributes to other ailments in smokers and nonsmokers alike.

Still, the deal falls short of what's needed to counter those threats.

For proof, look at how the stock market has embraced the deal. Investors have bid up tobacco shares, assuming the industry will continue to thrive. That is a sign that the deal is bad for public health.

Raeburn is BUSINESS WEEK's senior editor for science and technology.

Helping Smokers Quit



WHAT WORKS...

SMOKE-FREE WORK AREAS AND PUBLIC PLACES One of the most powerful steps to encourage quitting

ANTISMOKING ADS Ads must focus on industry attacks and adult role models

LARGE TAX HIKES Increases of up to \$2 a pack are needed to discourage smoking, especially among teens

REGULATING NICOTINE Reduces the addictive potential of cigarettes

...AND WHAT DOESN'T

AD BANS The industry currently has too many ways of circumventing them

PENALIZING MINORS FOR PURCHASING CIGARETTES Doesn't overcome the allure of advertising and other promotions

INDIVIDUAL SMOKING CESSATION PROGRAMS Helpful to some, but not worth a big effort

FEDERAL ANTISMOKING PROGRAMS Easily blocked by the industry; local efforts more effective

and Massachusetts each raised cigarette taxes 25¢ per pack and put the money toward tobacco control and health education. From 1992 to 1996, per capita consumption of cigarettes dropped by an average of 19.7% in Massachusetts and 15.8% in California, vs. 6.1% in the other 48 states.

The success was due to a combina-

GLOBAL WARMING: THE HEAT'S ON BILL

Clinton searches for a middle ground where there may be none

During the 1992 campaign, Bill Clinton and Al Gore vowed to have the most environmentally friendly administration in history. Five years later, after pledging to lead the world in the fight against global warming, the Clinton Administration has gotten cold feet. At a June 26 address to the second U.N. Earth Summit, Clinton planned to announce specific targets for reducing greenhouse gases in the U.S., although he has to set a number by December. His dithering has prompted European leaders to cry foul. In his U.N. speech, British Prime Minister Tony Blair warned: "No country can opt out of global warming or fence its own private climate."

Why are Clinton and Gore dawdling on an issue they once championed? In a world of politics, the Administration worries that the cost of cracking down on emissions could be greater than the benefits, for business, labor, Congress, and the public are reluctant to pay. "Unless we move slowly and steadily, we risk the American public there could be a backlash," says an Administration official. "The president wants to put this off as long as possible."

GETS LOOMING. The Clinton Administration has yet to release its analysis of the costs of setting an unofficial goal of at least halving emissions at 1990 levels by 2010. But the draft of the report outlined by BUSINESS WEEK spells out the Administration's math (see sidebar). While the overall impact on the U.S. economy would be negligible, the energy sector would be hit hard: By 2010, coal prices would be more than triple, to \$80 a ton. Gasoline at the pump would jump 26¢ a gallon, to \$1.54 a gallon.

HOW CLINTON CALCULATES THE COST OF COMPLIANCE

In an early White House draft, here's the price tag for cutting greenhouse-gas emissions to 1990 levels by 2010:

HIGHER GAS PRICES

The retail price of gasoline would rise about 26¢ a gallon.

SOARING COAL COSTS

Coal prices, which are now \$27 a ton, would triple, to \$80.

A NICKED GDP

The added costs would slow economic growth slightly, lowering gross domestic product in 2010 by 0.15%.

DATA: CLINTON ADMINISTRATION
INTERAGENCY ANALYTICAL TEAM



BENXI, CHINA: A "discernible human influence" on climate

But time is running out for the Administration. The U.S.—which alone emits 20% of the world's greenhouse gases—will be faced with specific emission targets in December, when representatives from 167 industrialized countries meet in Kyoto to forge a binding plan to counter global warming. European governments are pushing to reduce emissions by 2010 to 15% below 1990 levels, but the Clintonites consider that goal unrealistic. Their position is not

vastly different from the stance assumed by Clinton's predecessor, George Bush, who refused to sign a similar greenhouse treaty in Rio de Janeiro five years ago.

Since then, scientific evidence of the greenhouse effect has been piling up. A 1995 report by the U.N.'s Intergovernmental Panel on Climate Change found that "the balance of evidence suggests that there is a discernible human influence on global climate."

The scientists, who called for immediate action, predicted that the atmosphere would warm by 1.8 to 6.3 degrees Fahrenheit by 2100. That could cause disastrous flooding, food shortages, and extinction of plant and animal species. That prospect has even some business leaders concerned by the Administration's waffling. "It's frightening that this is being handled like a regular political issue," warns Paul H. O'Neill, chairman and CEO of Aluminum Co. of America.

WANNA TRADE? Clinton, who faces far more business leaders who oppose any emission treaty, is trying to broker an alternate deal. Under his strategy, companies in industrialized nations would buy and sell "carbon reductions." Like the pollution credits that are already traded in the U.S., they would allow a country whose emissions exceed its ceilings to buy rights from countries whose emissions are below their limits.

The Administration claims this could produce big savings: Without a trading scheme, it says, the cost of reducing a ton of carbon would be \$100, but the price falls to \$56 per ton if the U.S. trades with industrialized countries. The credits allow the U.S. to avoid the drastic emission cuts. But the plan is being met with skepticism abroad since it would allow industrial nations to continue polluting at unacceptable levels.

Environmentalists still want the U.S. to show leadership on the issue. "Clinton needs to stand up to special interests—expend a little political capital and do the right thing," says Daniel Lashof of the Natural Resources Defense Council. Ultimately, whatever Clinton decides to do about global warming, he's likely to get the cold shoulder.

By Mary Beth Regan, with Amy Borrus in Washington



DETROIT

MORE THAN A SPEED BUMP AT CHRYSLER?

Probably not. But as sales slip, CEO Eaton is taking no chances

The second quarter of 1997 will not be one that Chrysler Chairman Robert J. Eaton will remember fondly. Sales dropped 11% in April and 17% in May. Analysts predict as much as a 10% dip in June. The company's U.S. market share slipped to 14.6% in May, from 16.5% a year earlier. Because of a month-long engine-plant strike and slow sales, Chrysler's second-quarter profits will be about \$500 million—half of what it earned the same time last year.

Without a doubt, the hottest auto maker in Detroit has hit a speed bump. After smashing several sales and profit records since late 1995, Chrysler has lost its Midas touch. Even its most popular vehicles—Ram pickups, Dodge minivans, and Jeep Grand Cherokees—are slipping. Rams are in an outright slump. Eaton, who is downbeat about the U.S. market, is not expecting a quick recovery, despite high hopes for new models. "The market out there is not as strong as even the numbers would indicate," he says.

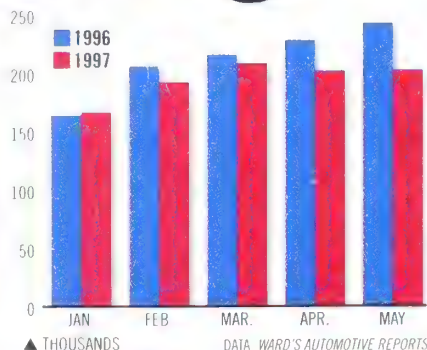
As a result, Eaton is falling back on Chrysler's cost-cutting skills, ordering \$1 billion in cuts. He laid on a hiring freeze and told Chrysler executives to reevaluate every expense that doesn't affect product quality. Chrysler's future product plans are undergoing more scrutiny than ever, with two anticipated new models—the Jeep Dakar sport util-

ity vehicle and the Dodge Copperhead—still under review by top management.

Chrysler execs concede that last year's record-breaking run led to a bit of complacency. Budgets were stretched with new hires, outside consultants, and inflated travel expenses. "Everybody starts saying 'yes' to marginal things

FALLING BEHIND LAST YEAR'S PAGE

Sales of Chrysler cars and trucks



AGING MODEL

Dodge Ram lost sales to Ford

NEW TALENT

Dodge Durango could be a strong contender

they wouldn't 'yes' to in marginal times," says Chrysler official.

Chrysler's m

difficult problem is a lack of new products. "Some of the models are just getting older," says James M. McInerney, Dodge dealer in suburban Detroit. The Ram, which faced supply problems because of the engine-plant strike, sales to the newer F-Series pickup from Ford Motor Co. Stalwarts such as the Grand Cherokee—which gets redesigned next year—now seem passé compared with newer sport utility vehicles from Ford, Toyota, and Honda.

"RECESSION MODE." Chrysler's biggest weakness is in passenger cars, where Japanese rivals are strongest. Chrysler's share is less than 10%. Even rebates have not spurred sales of its model sedans—Chrysler Cirrus, Dodge Stratus, and Plymouth Breeze. The compact Neon is also underperforming.

The Chrysler lineup will get some new talent this fall: redesigned Chrysler Concorde and Dodge Intrepid sedans and a new Dodge Durango sport utility. The Ram-resembling Durango looks like a strong contender. It has three rows of seats like the big Ford Expedition. General Motors Corp.'s Suburban, but at a lower price tag.

To launch these vehicles, Chrysler is going ahead with commitments to increase engine and transmission capacity and to retool assembly plants in Ontario, Canada, and Newark, Del. In fact, Chrysler also recently decided to proceed with the replacement of the aging Toledo factory.

In the short term, Chrysler—and its rivals—are fighting the surging Japanese with discounts. Eaton has raised average per-vehicle incentives, such as rebates, to \$975 from \$705 in the first quarter. "There's no question that incentives are helping the market," he says.

Wall Street sees Chrysler's detour as temporary. Its stock—along with that of other car companies—has underperformed the market, holding at about \$32. But analysts figure Chrysler will earn close to \$3 billion on revenue of \$9 billion this year, compared with \$3.5 billion on sales of \$61.4 billion in 1996. Essentially, Chrysler is "going into a recession mode without having a recession," says David Healy, an analyst at Burnham Securities Inc. But Eaton has said he wants to be the first Chrysler CEO not to preside over a comeback. To succeed, he has to avoid a real downturn.

By Bill Vlasic in Detroit

FROM BIG OIL TO BEHEMOTH OIL

Having downsized and spun off, the industry turns to M&A

It's the kind of bare-knuckles play seldom seen in the oil patch lately: On June 23, Union Pacific Resources Corp., the largest U.S. independent oil and gas exploration company, launched a hostile bid for Pennzoil Co. Union Pacific sources called Pennzoil's managers "willing or incapable" of executing its business, and attacked the company's takeover defenses in court in three weeks. Houston-based Pennzoil agreed to respond by July 7.

biggest companies, which have cash burning a hole through their balance sheets and a need to find ways, beyond cost-cutting and joint ventures with each other, to make more money. In addition, all the majors are carrying what industry experts consider low levels of debt—primarily because exploration costs are falling and there are not enough potential new reserves in which to invest. Says Morgan Stanley Dean Witter analyst Douglas T. Terreson: Mergers are "the next logical step."

even acquire a company the size of Amoco Corp. without diluting earnings, analysts calculate. While Exxon declined to comment, it has in fact told analysts it is unhappy with its present debt level, a low 15% of total capital.

The low debt ratio in the capital-intensive oil business is a sign to analysts that companies are not making the investments that will produce future earnings. Typically, the industry's debt-to-equity ratio is in the mid-30s. Adam Sieminski, vice-president and oil analyst at NatWest Securities Corp., estimates the average industry debt-to-equity ratio, currently about 25%, will drop below 10% by 2001, if this trend continues. "That [low number] doesn't make a lot of sense," Sieminski says.

For Union Pacific Resources, at least, it makes sense to plow money into new



FIELD, CASPIAN SEA: A ding war for Pennzoil's reserves? Whatever the outcome, the battle signals a new phase of industry consolidation. Having downsized, spun off non-core operations, and restructured, Big Oil is now turning its attention to mergers and acquisitions, say investment bankers and analysts. With low debt levels, soaring competition for new reserves, friendlier regulators, and pressure to boost returns, combining some of the biggest players could be the simplest, most effective way to raise the bottom line. Or so the logic goes.

SUPERMAJORS. Already this year, M&A activity in oil has reached \$20.5 billion, easily destined to surpass the \$28.3 billion spent on deals in 1996. "We're poised for a record year if this trend continues," says Securities Data Co. analyst Richard J. Peterson.

So far, that consolidation is most apparent among the fast-expanding group of small and midsize oil companies. But the trend is expected to spread to the

The result, says Terreson, will be the emergence of a new type of elephantine oil enterprise—what he's calling the "supermajors." He predicts the urge to merge will soon engulf companies the size of Atlantic Richfield Co., Texaco, and Mobil. And once it starts, the pace should be brisk as companies race to find the most desirable properties. "The timing is right for these large transactions because capital markets are fluid," says Roswell F. Vaughan III, a managing director in Prudential Securities Inc.'s energy investment banking group.

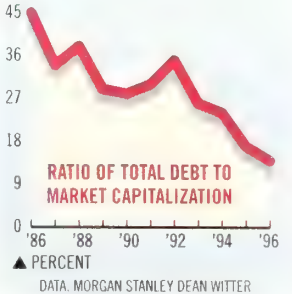
Even giant Exxon Corp., with \$134 billion in annual revenues, might bid for a peer company, say analysts. With a price-earnings ratio of 22, Exxon could

reserves. That's the logic behind its \$6.4 billion bid for Pennzoil. Spun out of Union Pacific Corp. in October, 1995, the feisty driller has a nearly \$7 billion market cap, little debt, and a need for new places to drill.

Union Pacific Resources is particularly interested in Pennzoil's U.S. properties. Its \$84-a-share offer, with its 41% premium over Pennzoil's closing price on June 20, represents an attempt to preempt rivals who are interested in the rich reserves that Pennzoil owns in the Caspian Sea, say analysts. Union Pacific Resources Chairman Jack L. Messman says that he's "in it for the long haul," no matter what defenses Pennzoil throws up. Analysts believe international oil companies such as Elf Aquitaine, Total, and

TIME FOR DEALS?

The top seven international integrated oil companies' balance sheets put them in a position to make major acquisitions.



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Royal Dutch/Shell Group could still enter the bidding.

Even if a white knight doesn't appear, James J. Manzi, a vice-president at Mercer Management Consulting, says the Union Pacific Resources offer won't be the last big deal this year: "There is a very active rumor mill around lots of independents and majors combining operations." Among the most frequently mentioned targets: The Coastal Corp. and DuPont Co.'s Conoco Inc. Both companies declined comment.

To oil-patch veterans, such talk is a red flag—a warning that the merger-mania of the 1970s and 1980s could return. Back then, raiders like T. Boone Pickens Jr. forced such companies as Phillips Petroleum Co. to sell off assets and take on crushing debt to stay independent. But what about the reaction of regulators? So far, alliances among the majors, such as production joint ventures by Amoco and Shell and the proposed linking of Texaco and Shell refining and marketing arms, haven't

raised many eyebrows. And given M&A free-for-all in other industries, many analysts don't expect many roadblocks for oil. "We're beyond the raider era," says Messman. "When it's economically driven, it's politically acceptable."

And the economics do seem to dictate merger. Certainly Wall Street—which sees big bucks in M&A frenzy—is cheering UPR and others on. This is one industry in which it may be possible to repeat the past and still profit.

By Gary McWilliams in Houston

COMMENTARY

By Linda Himelstein

NIKE HASN'T SCRUBBED ITS IMAGE YET

Nike Inc. must have hoped that hiring a dignitary like Andrew Young—the former civil-rights leader, mayor of Atlanta, and U.S. ambassador to the U.N.—would at least quiet some of its labor-activist critics. But even before Young released his long-awaited report on conditions at Nike's overseas plants on June 24, human-rights groups were crying foul.

Their main beef is a valid one: The report all but ignores what may be the most important concern of Nike's foreign workers—wages. Young says he deliberately avoided the topic because he wasn't qualified to assess pay in a global economy. And he says it's unfair to single out the \$9 billion company when it pays workers just as much as rivals do. "The minimum standards have to be put in place by the governments involved," says Young, who wrote the 75-page report with his Atlanta consulting firm, GoodWorks International LLC. "I don't know that any one company can do that."

UNDERMINE. Skirting the wage issue undermines a report that could have put to rest charges of worker abuses and systemic problems. "We were hoping that Andrew Young would come out with something significant," says Medea Benjamin, director of the human-rights group Global Exchange in San Francisco. "But this report is meaningless."

At Nike's expense, Young spent 15 days in March and April touring 12 factories in China, Indonesia, and Vietnam. He says Nike let him go anywhere he wanted and speak with any worker he chose—but he admits that Nike officials served as interpreters for most of his interviews.

In the end, he said, he saw no evi-

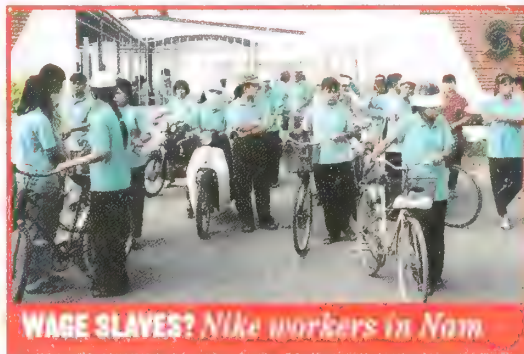
dence of "systematic abuse or mistreatment" of workers. "I was expecting to see a far worse situation," says Young, who will only reveal that his pay was less than his usual fee for a speech.

Young didn't let Nike off completely. For example, he said the Beaverton (Ore.) athletic-shoe maker needs

to teach workers better about their rights and implement a third-party monitoring system. But these recommendations, which Nike vows to implement, seem inconsequential unaccompanied by a discussion of wages. Critics say Nike pays workers below subsistence levels and far less than other U.S. companies in Asia, such as Coca-Cola, Gillette, and Goodyear.

Nike contends it pays workers well—and no less than its rivals do. And it says its foes don't give Nike credit for its efforts to improve workplace conditions. "There's no way any report would convince the human-rights groups, who are saying that Andrew Young has been bought, of something other than their biased beliefs," says Lindsay D. Stewart, Nike's vice-president of law and corporate affairs. Still, Nike might have stood a better chance if Young had addressed all the issues on the table.

Linda Himelstein covers Nike from San Francisco.



WHAT ANDY YOUNG FOUND

- Factories that produce Nike goods are "clean, organized, adequately ventilated, and well-lit"
- No evidence of a "pattern of widespread or systematic abuse or mistreatment of workers"
- Workers don't know enough about their rights or about Nike's own code of conduct
- Few factory managers speak the local language, which inhibits workers from lodging complaints or grievances
- Independent monitoring is needed because factories are controlled by absentee owners and Nike has too few supervisors on site



BACKED UP AT THE BORDER

Companies like Fisher Price have moved production from Asia to Mexico—creating jobs for American drivers who truck the toys

plant relocations more real. "NAFTA has created a climate that has emboldened employers to threaten workers," says Kate Bronfenbrenner, a Cornell University labor economist. In a three-year survey released in June, she found that 60% of union organizing efforts in manufacturing after NAFTA were met by management threats to close the factories, compared with 29% before NAFTA.

Actually, NAFTA's impact on jobs hasn't approached the debacle that critics had predicted—the famous "giant sucking sound." The Labor Dept. has certified—under a program that gives displaced workers retraining and unemployment relief—that 128,303 U.S. workers have lost their jobs so far because of increased competition from Mexico and Canada. That compares with 2.2 million jobs created each year since NAFTA took effect.

RIPPLE EFFECT. To see why job losses haven't been as drastic as once feared, look at Lucent Technologies. The company set up a *maquiladora* plant in Guadalajara in 1991 that produces 95% of Lucent's phones and answering machines. Under NAFTA, the plant has been buying more components from U.S. suppliers, while cutting back on Asian sources. Miles Press, a \$2 million maker of directory cards based in Indianapolis, has seen orders from Lucent grow by 20% over the past few months. And St. Louis-based Berg Electronics, a \$700 million component maker, expects to triple sales to Lucent's Guadalajara plant next year.

A ripple effect has generated U.S. service-sector jobs as well. Fisher Price Inc. shifted toy production, mostly for the U.S. market, from Hong Kong to a plant in Monterrey. That has helped Celadon Trucking Services Inc., which moves goods produced for Fisher Price from Mexico, add 800 new U.S. drivers to the payroll.

That doesn't help low-wage workers in nonunion plants, where the NAFTA card is being played. But the Clinton Administration's mixed report on NAFTA probably won't be the last word. With the peso crisis receding and the U.S. economy still roaring, NAFTA's lasting effects may not be clear for years.

By Paul Magnusson in Washington, with Elisabeth Malkin in Mexico City, Bill Vlasic in Detroit, and bureau reports

ADE

NAFTA: WHERE'S THAT GIANT SUCKING SOUND?

Workers feel a squeeze, but so far few U.S. jobs are going south

The election was drawing near in an organizing drive by the United Auto Workers at three ITT Industries auto-parts plants in northern Michigan. Then, management brought Mexicans to film Americans as they grieved about their jobs. An assembly line was shut down, and the equipment was loaded onto flatbed trailers marked: "Mexico Transfer Job."

The ITT workers got the message and voted down the union. "The implication is, if you form a union, we will ship our stuff out to Mexico, and we can do it in a heartbeat," says Diane Ketola, a UAW organizer in the 1995 effort. ITT denies any efforts to discourage workers from unionizing and is appealing a National Labor Relations Board finding of unfair labor practices in the incidents.

THREATENING CLIMATE. As the Clinton administration compiles its first official report on the agreement, use of the NAFTA card to thwart union efforts will stand out as one of the few negatives. The AFL-CIO, however, insists that NAFTA has helped keep inflation-adjusted average hourly earnings of U.S. production workers flat, at around \$12 an hour.

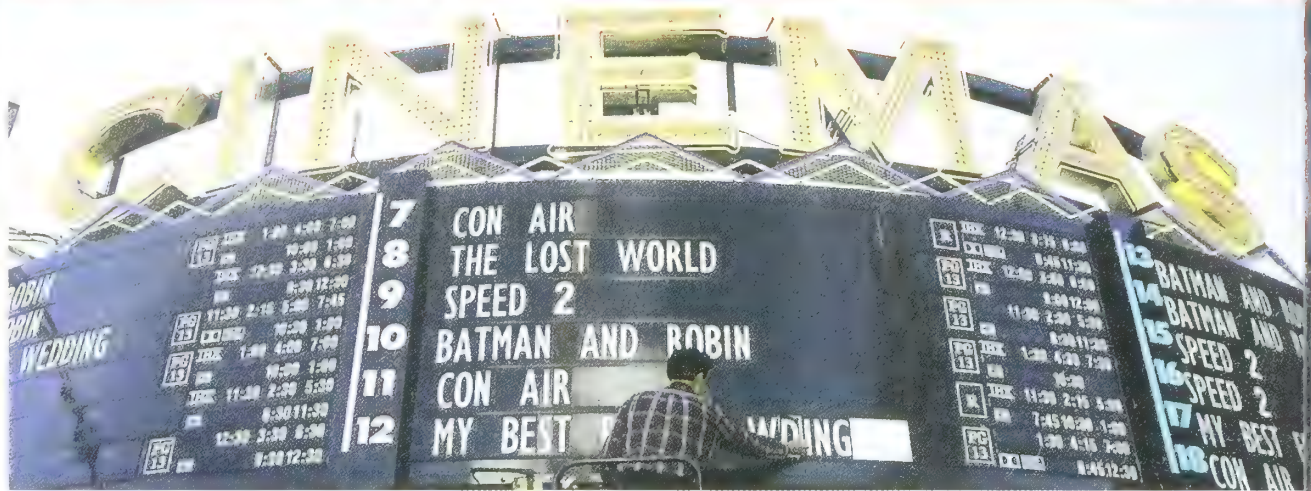
The lack of wage growth and other alleged NAFTA evils are certain to be cited by critics of the Administration's quest for authority to make market-opening moves in the rest of Latin America. That means the White House

is all the more eager to put the controversy over NAFTA to rest. "The fact of the matter is, in 1993, people were screaming that the sky was going to fall, and that hasn't happened," says Commerce Secretary William M. Daley.

The Administration prefers to point to expanded exports to Mexico and evidence of a declining trade imbalance as the Mexican economy recovers from the perilous peso decline of 1994. Its report is not likely to dwell on NAFTA's impact on collective bargaining and union organizing drives. After all, as the Administration can point out, U.S. companies already had the capability to move production to Mexico before NAFTA took effect in January, 1994. But because NAFTA made investing in Mexico safer, it also made the threat of

THE POST-NAFTA PATTERN





ENTERTAINMENT

NOW PLAYING ON SCREEN 29...

Megaplexes are taking over, driving out the smaller chains

In Ontario, Calif., a dusty suburb 40 miles east of Los Angeles, moviegoing has become a competitive sport. On one side of the two-lane road that winds through the giant Ontario Mills shopping mall, the AMC offers 30 screens that include *Speed 2: Cruise Control* and *Liar Liar*. On the other, Edwards Cinemas counters with *Batman & Robin*, *Austin Powers*, and *Con Air* on its 22 screens. Even on a Sunday, with 90,000 fans diverted to nearby California Speedway, the parking lots are full. "The great thing is you can't get shut out," says Laura Placo, scanning start times for *The Lost World: Jurassic Park*, showing on no fewer than eight screens and just minutes apart at AMC and Edwards.

The Megaplex Age is coming. At a time when the average U.S. multiplex theater offers about five screens, exhibitors are scrambling to build theaters with as many as 30. The boom will transform the way consumers pick and watch their movies. And with each megaplex costing upwards of \$30 million, it's a game for giants. "It's becoming a capital-intensive business," says Michael L. Campbell, chairman of Regal Cinemas Inc., the nation's fifth-largest chain, with 169 theaters and 1,403 screens. "Middle-tier companies with limited resources have to wonder how they are going to play in this game."

Even the giants may find the going rocky. The number of screens is growing

far faster than box-office grosses. Hence, each screen is taking in less. Chains have been trying to push up ticket prices but are concentrating on concession sales and cutting costs to compete. And they are consolidating: Toronto-based Cineplex Odeon Corp. has confirmed that it is in talks to merge with Loews Theaters, a 900-screen New York-based division of Sony Corp. The deal, a stock transaction said to be worth nearly \$200 million, would create the second-largest chain in North America, with nearly 2,500 screens in the U.S. and Canada. It would be particularly strong on the East Coast and in Chicago.

Campbell's Regal intends to be one of the surviving giants as well. It soon will close a \$200 million deal to buy Cobb Theaters' 643 screens. From its strongholds in the Southeast, it plans to add 1,100 new screens at a cost of \$150 million and convert itself to a chain of mostly 16- to 24-screen multiplexes.

More, bigger multiplexes are also planned at AMC. It wants to convert all of its theaters to 14- to 30-screen megaplexes and will spend \$509 million

through 1998 to add 725 new screens. Carmike Cinemas, National Amusements, and Cinemark USA also are planning to build large multiplexes.

And more mergers are likely. Already, the largest 3% of the chains control over 60% of the nation's screens, figures Cowen & Co. analyst Paul Marsh. But the economies of scale from size and regional concentration make consolidation all but inevitable.

POPCORN POWER. The largest megaplexes wield considerable clout when it comes to negotiating with studios to get the most promising movies. The chains pour up to 90% of their ticket sales for a blockbuster in its first weekend. *How to Succeed in Business Without Really Trying* is showing hot new films on several screens at once can boost admissions and concession sales. Attendance per screen is 38% higher at AMC's 16-plexes than at its smaller theaters, and revenue from ticket sales and concessions runs as much as 10% higher.

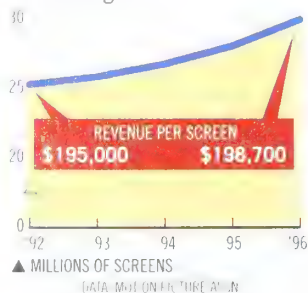
Keeping the audiences coming is key to theater survival, and despite the competition of megaplexes, theater execs see a payoff. New and upgraded facilities with lots of screens and such amenities as

baby-sitting services and cappuccino bars stand to grab more consumers and keep them there longer. "People still need to get out of the house, but they're more picky about what they want to spend their time," says Phil M. Singleton, president of AMC's theater unit. For theater chains, the idea is to get them into a multiplex instead of a video store.

By Ron Grover
Los Angeles

BOX-OFFICE BLUES

The number of new screens has risen 18% since 1992, but the revenue for each has failed to grow.



ISIDERS, WATCH OUR BACKS

High court ruling sharpens SEC's enforcement power

For nearly two decades, the Supreme Court has been Public Enemy No. 1 for anyone bringing a securities fraud suit. It has shortened the time for filing suits and barred claims against lawyers, accountants, and investment bankers accused of aiding scams. And it has tossed cases against printers and financial analysts accused of trading on or spreading inside information. But on June 25, the justices upheld the conviction of a Minneapolis lawyer who stole inside information from his client, which represented a buyer in a tender offer. The justices bought the argument that insider trading bans aren't limited to execs and their close advisers. "This is a good decision for all investors and market integrity," says William R. McLucas, the Securities Exchange Commission enforcement chief, who calls it the biggest victory for agency in 15 years. The ruling could



The ruling, written by Ginsburg, involves a lawyer who pocketed over \$4 million on an inside trade

cases typically involve those who violate a legal duty to shareholders. But under misappropriation, the trader need only have a duty to the information source—in this case O'Hagan's firm and Grand Met. Ginsburg said that not everyone has equal access to data, but "investors likely would hesitate to venture their capital in a market where trading based on misappropriated, nonpublic information is unchecked by law."

make the SEC much more aggressive. The 6-3 decision, written by Justice Ruth Bader Ginsburg, reverses an appeals court ruling that tossed out the conviction of James H. O'Hagan, a partner in the law firm Dorsey & Whitney. In 1988, while his partners represented Grand Metropolitan PLC as it prepared a tender for Pillsbury Co., O'Hagan started buying call options on Pillsbury shares. He later bought stock and eventually made more than \$4.3 million. The ruling bolsters the "misappropriation" theory, where the SEC simply goes after people who steal confidential information and trade on it. Insider trading

Some lawyers were stunned at the outcome, partly because the court had been so hostile to securities litigation and partly because it usually interprets criminal laws more narrowly. "I'm surprised," says Arthur F. Mathews, a Washington (D.C.) securities lawyer. "The pendulum seems to have swung." Can the SEC now nab everyone from office cleaners to psychiatrists who get inside dope? Future rulings will tell. But for now, the justices seem willing to leave at least a few arrows in the government's antifraud quiver. By Stan Crock in Washington

COMMUNICATIONS

BULGING UP FOR BATTLE

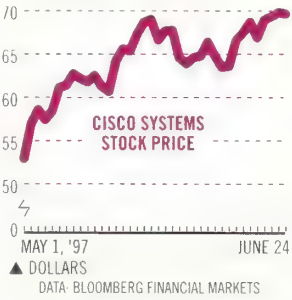
Cisco takes the lead in networking buying spree

All it networking's winter of discontent. After two years of torrid 60%-plus growth, makers of data communications gear caught a chill in the first quarter of 1997 as customers paused to digest their multibillion-dollar feast of new equipment. Investors worried about a protracted slowdown reacted by selling down the shares of highfliers such as Cisco Systems and 3Com Corp. as much as 28% and 62%, respectively, between January and April. Now, there's a warming trend sweeping the business. Second-quarter numbers are rolling in, and the networking business as a whole is back on a 30% growth path. Only, not everybody's king. While big companies like Cisco and 3Com are getting fatter, smaller fits such as Fore, Xircom, Xylan, Edge Networks, and Cabletron Systems are turning in disappointing results. That could accelerate the consoli-

dation that has already moved 82% of industry revenues into the hands of the top four giants, according to Robertson, Stephens & Co. No company typifies this trend more than Cisco. With its stock up 56% in the last two months and a cash hoard of \$1.3 billion, Cisco is once more in a buying mood. On June 24, it paid \$200 million to add two more companies to its bulging portfolio: Global Internet Software Group in Palo Alto, Calif., a maker of Internet security software, and Ardent Communications Corp. in San Jose, a startup specializing in network gear for combining voice, data, and video traffic on high-speed communications lines. The deals buttress Cisco's position as the No. 1 networking company, with projected revenues of \$5.88 billion in the year ending July 31, according to Noel Lindsay of Deutsche Morgan Grenfell. 3Com, networking's No. 2, is on the upswing, too. It just acquired modem-maker U.S. Robotics Corp., creating a \$5.5 billion behemoth that commands top position in modems and PC networking cards. "We outgrew our com-

petitors," says CEO Eric Benhamou. Where does that leave competitors like Bay Networks Inc. and a score of smaller players? Many are trying to buy their way into the big league. Bay, for instance, announced June 19 that it would acquire Rapid City Communications, a startup that makes high-speed data switches. But Bay is still recovering from years of misdirection, and earned only \$255,000 in the quarter ended March 31 after a \$32 million restructuring charge. "The small guys are becoming like the walking dead," says analyst Don Miller of Dataquest. FRANCE, TOO. The sheer size and momentum of the top dogs give them an edge in forging partnerships. Cisco, for instance, is working closely with Microsoft Corp. to develop new networking technology for Windows NT. And on June 23, it announced a sweeping agreement with French communications giant Alcatel Télécom. With partners like that in its camp, Cisco will continue to pull away from the pack. That could leave small networking competitors out in the cold. By Andy Reinhardt in San Francisco

ON THE REBOUND



EDITED BY KELLEY HOLLAND

SQUASHING AN ASBESTOS DEAL

THE SUPREME COURT HAS halted a \$1.3 billion global settlement between 20 manufacturers of asbestos and hundreds of thousands of current and future claimants. In a 6-2 decision on June 25, the court took issue with the settlement's equal treatment of current and future claimants. The ruling stands to make it far more difficult to reach large settlements in future class actions. In recent years, public advocates have complained that plaintiffs and defense attorneys have been too quick to reach class-action settlements that don't reflect the interests of all members of the class. The court said that

under a federal court rule, a class had to have common interests and characteristics and this class didn't meet that standard. A spokesman for the asbestos makers says: "We are determined to alleviate the backlog of individual claims that are clogging the nation's courts."

WHY SNET IS IN A SNIT

LET THE TELEMARKETING blitz begin. Starting next March, Connecticut residents must pick a local phone company as the state becomes the first to deregulate fully its local service. Those who don't choose will be assigned to 1 of 21 carriers at random, state regulators have decided. Southern New England Telecommunications (SNET) is not happy about the sweepstakes. The former local monopoly had hoped to be the default carrier—automatically assigned to consumers who won't make a choice. Now that it won't be, the company is warning that 1998 earnings could be hurt.

EXXON: FILL IT UP WITH REGULAR

REMEMBER THOSE EXXON ADS claiming that high-octane gas keeps car engines cleaner and reduces maintenance? Get ready for a very different campaign. In a landmark settlement on June 24, the Federal Trade Commission announced that Exxon would run new ads advising consumers that for most cars, regular gas has the right octane. The settlement follows a September, 1996, FTC complaint charging Exxon with misleading consumers by making unsubstantiated claims about high-octane gas. Beginning in September, the 15-second ads will run in 18 major metropolitan markets.

HEADLINER: ECKHARD PFEIFFER

IN TANDEM WITH TANDEM

A year ago, he vowed to double annual revenues by 2000, pushing Compaq Computer to \$40 billion in sales. And CEO Eckhard Pfeiffer isn't one to miss a target. On June 23, he gave himself a little boost by agreeing to buy struggling Tandem Computers, the largest maker of "fault-tolerant" computers.

The stock deal, valued at around \$3 billion, does two things: It gives Pfeiffer \$2 billion a year from sales of Tandem systems, which are used to run bank ATM networks, stock exchanges, and phone switching centers. And it

gives Compaq 4,000 sales and service experts used to dealing with big corporate buyers, doubling Compaq's force. "It accelerates our plans dramatically," says Pfeiffer. Compaq is also getting Tandem for a song, paying just 1.5 times sales.

The deal comes after Compaq kicked the tires at \$14.5 billion Digital Equipment, among others. Is Tandem the consolation prize? Not according to Pfeiffer: "This is the one we wanted to make," he says. Now he has to make the combo work.

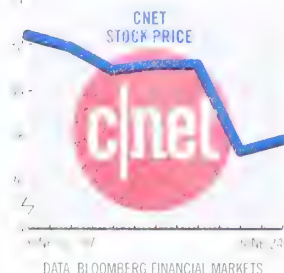
By Gary McWilliam



CLOSING BELL

NET DROP

CNET is betting there's room for another online service, but investors aren't so sure. On June 23, the Internet publisher announced plans for a September launch of Snap! Online, an Internet navigation and information service to compete with America Online, Yahoo!, and Excite. But worries about the cost of building the service, which Deutsche Morgan Grenfell estimates at \$37 million through 1998, sent CNET's stock plummeting 13%, to 27%. Startup costs could delay profitability for CNET until fall 1998. Some analysts think the service could eventually be a winner, but others say it might be too late.



PAXSON'S RADIO SIGN-OFF

THE RADIO MAN IS DOUBLING up his bets on TV. On June 23, Lowell "Bud" Paxson, chairman and CEO of Paxson Communications, who started in radio in the '50s, agreed to sell all 46 of Paxson's radio stations and some other assets to Clear Channel Communications for \$693 million. He will use the proceeds to close on a half-dozen TV stations. Paxson's TV properties got a boost in March with the Supreme Court's "must-carry" ruling that requires cable companies to include all broadcast channels, and he's now trying to forge a new network.

ABC: A NEW BOSS FOR JAIME TARSES

IF ONLY THE SHOWS ON ABC were this intriguing. On June 24, the third-place network announced that longtime pro-

gramming executive Stu Bloomberg would be installed as chairman of ABC Entertainment. The move came after weeks of industry talk that Jamie Tarses, president of ABC Entertainment, was headed for the exit after a disastrous first season inherited from her predecessor. Tarses was brought to ABC from NBC by Michael Ovitz during his brief, unhappy stint as president of parent Walt Disney. No word yet on Tarses' plans.

ET CETERA...

- Swiss banks will publish names of those holding dormant accounts on July 23.
- Eli Lilly is taking a \$4 billion charge for its Health Systems unit.
- Qwest Communications shares rose 27% on the first day of trading.
- Liposome's stock plunged 61% on news of a disappointing study of its drug Venti-



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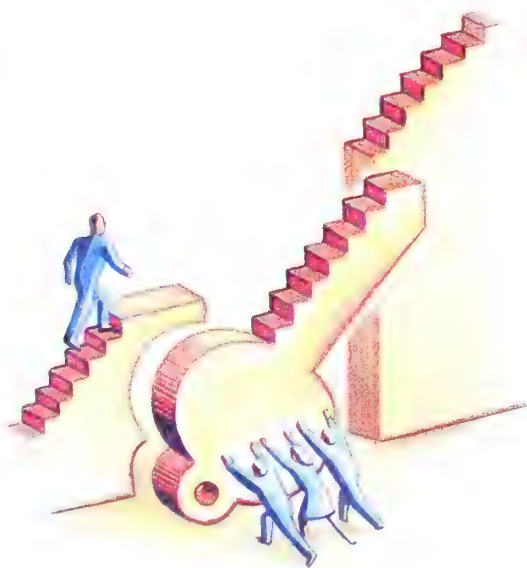
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EDITED BY OWEN ULLMANN

LINTON LOOKS READY TO CUT A DEAL ON PRODUCT-LIABILITY REFORM

American manufacturers' 20-year quest for product-liability reform looked like Beltway roadkill last year. Faced with a measure limiting the damages consumers could exact from makers of defective products, President Clinton put his foot on the veto pedal. And no one cheered louder than the trial lawyers who were big Bill backers. That was then. Now the White House and Senate Republicans are suddenly searching for a compromise, and business has its hopes up. The President, who has always favored the idea of reforming the legal system, wants to sign something—as long as it doesn't look like a flip-flop.

Clinton's complaint last year was that the bill went too far in protecting companies from multimillion-dollar jury awards, especially by setting a \$250,000 ceiling on punitive damages. That limit remains in dispute, but business was buoyed on May 1 when the Senate Commerce Committee approved a bill that addressed other Presidential objections. For instance, the revised measure wouldn't limit damages in cases where a gun dealer sells a weapon to a minor. Nor would it impose limits in cases involving suppliers of raw materials for silicone breast implants. And the GOP is hinting at more flexibility: Commerce Committee Chairman John McCain (Ariz.) says the measure could be reworked further in the Senate floor. Moreover, Hill sources say Majority Leader Trent Lott (Miss.) is eager for an agreement.

The White House seems inclined to deal as well. Clinton has named a high-level task force headed by National Economic Council chief Gene Sperling and White House Deputy Counsel Bruce R. Lindsey to work on revised legislation.

June 19, Sperling and Lindsey met with Caterpillar CEO Donald V. Fites, Tenneco CEO Dana G. Mead, and National Association of Manufacturers head Jerry J. Jasinowski. "We do see there is a window of opportunity for bipartisan collabora-

tion," Jasinowski says. "They were interested in seeing if we can get a bill." Negotiations with Senate Republicans could start in July.

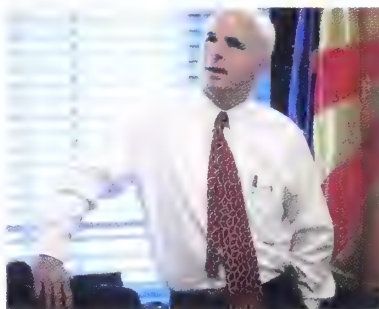
Some of Clinton's closest Democratic allies also favor product-liability reform. Senators John D. Rockefeller IV of West Virginia, and Christopher J. Dodd and Joseph I. Lieberman of Connecticut have pressed him to support legislation, and he would like to come to their aid this time. After the last veto, Rockefeller accused Clinton of repaying the Association of Trial Lawyers of America, which gave Dems \$581,000 for the 1996 campaign. Now with the election behind him, Clinton

is more willing to work with business. "The White House has always been uncomfortable with the President being so closely identified with trial lawyers," says a Democratic Hill staffer.

VAGUE VETO. But talking compromise and reaching one are two different matters. Besides keeping the \$250,000 cap, the bill would prohibit juries from holding one company liable for all noneconomic damages, such as pain and suffering, if it was found only partly responsible for a defective product. Clinton is opposed to both changes. An aide says any shift in position would have to be "consistent with the President's veto statement." But both Clintonites and the GOP say the vagueness of his veto left plenty of wiggle room.

A Clinton compromise is sure to trigger protests from trial lawyers and consumer groups. They claim manufacturers would have less incentive to make safe products if the right to sue is curtailed. Clinton bought that argument last time—and he may yet again. But for now, he seems to enjoy being the Dealmaker-in-Chief who worked with the GOP to overhaul welfare and balance the budget. Product-liability reform could be another notch on his legacy belt.

By Susan B. Garland, with Mike McNamee



McCain: Hints of more flexibility

CAPITAL WRAPUP

LEADING THE VOTE ON CHINA

The 259-173 House vote on June 24 backing most-favored-nation trade status for China signals a shift to the center by younger Democrats. Some 44% of Democratic freshmen and sophomores backed MFN, compared with 51% of the remaining Dems. Overall, 112 members split with Minority Leader Richard A. Gephardt (D-Mo.). Gephardt also lost a majority of his caucus in May, when Dems voted 132-72 in favor of the balanced-budget accord, which he opposed.

Conclusion: The liberal base supporting an expected Gephardt Presidential bid in 2000 is shrinking.

FIRE-SALE AIRWAVES

► To reach a balanced budget in 2002, the Senate expects to pull in \$20 billion from sales of spectrum to broadcasters and telecom companies. But that estimate looks wildly optimistic. The Federal Communications Commission figured it could raise \$1.8 billion from an auction of wireless services last April. Instead, the take was a mere \$14 million.

HOT SPOT... FOR TOURISTS?

► American tourists may soon be able to visit a new Mediterranean resort: Beirut. Administration officials say Secretary of State Madeleine K. Albright is reviewing a proposal to rescind the U.S. travel ban on Lebanon, imposed during its civil war in the 1980s. French President Jacques Chirac pushed Clinton during the economic summit in Denver to reverse the U.S. position. The White House says a decision is expected "in the very near future."

A NEW BREED OF BLUE CHIPS

They're lean, boast global brands, and give lots of value

Nobody likes a braggart. So Bill Clinton didn't exactly get a standing ovation at the mid-June economic summit in Denver when he extolled, again and again, America's magic formula for growth. Indeed, his fellow world leaders barely hid their resentment when the President suggested that U.S. advisers help Japan untangle its regulatory snarls and that Europeans follow the American example and slash their swollen budgets.

Stock buyers, though, couldn't care less about modesty. This year's BUSINESS WEEK Global 1000 shows that investors think Clinton is right. For the fourth year in a row, U.S. companies increased their presence in our tables of the world's most highly valued companies. America added 25 corporate names to the list, bringing its share of the ranking's total market capitalization to nearly 50%.

Using data compiled by Geneva-based Morgan Stanley Capital International, BUSINESS WEEK has since 1988 been ranking about 2,700 companies in 21 countries by market capitalization. Because results are stated in dollars, currency fluctuations over the years have influenced how far countries rose or fell in the standings. For example, thanks to the dollar's strength in the past 12 months, the healthy gains posted by European bourses were even stronger in local-currency terms. And the 17% shrinkage in Japan's

overall market capitalization would have been just 11% if stated in yen.

Yet even allowing for the dollar's rise, the shifting balance of power in the Global 1000 reflects long-term economic trends. Japan has been steadily losing heft in the rankings since 1990, when it accounted for 39% of the list's total market capitalization. Now, Japanese companies represent 16% of the total, down from 23% last year, while Japan lost 45 companies from the list.

Nor do this year's results simply re-

flect the bull run on Wall Street and the bearish mood in Tokyo. The U.S. keeps gaining ground in the global economy not just because its stock markets are booming but also because many of the companies dominate the world's fastest-growing industries. Indeed, global competition has created a brand-new class of blue chips. Investors no longer set aside big-cap companies with steady sales and strong domestic market share. They want a worldwide brand name, super-efficient production, lean management,

and an outspoken commitment to shareholder value. So companies such as Coca-Cola, Sony, Novartis, and Volkswagen came out winners regardless of how their domestic stock markets did.

Two names new to the list tell the story. Microsoft Corp. and Intel Corp., the West Coast companies that provide the software and chips, respectively, for the lion's share of the world's personal computers, both made it into the top 10 for the first time ever (table). PCs had another banner year, with 18% unit growth, and "Weltel," as the duo are commonly known, reaped the rewards.

Windows 95 really kicked in for Microsoft this year. In the quarter ended in March, the percentage of new PCs with Windows 95 preinstalled grew to more than 75% of reported shipments, and Windows 3.1 and Windows NT workstation

How the Giants Stack Up

SALES (BILLIONS OF U.S. DOLLARS)			PROFITS (BILLIONS OF U.S. DOLLARS)		
1	GENERAL MOTORS	\$164.07	1	ROYAL DUTCH/SHELL GROUP	\$9.31
2	FORD MOTOR	146.99	2	EXXON	7.51
3	MITSUBI & CO.	140.14	3	GENERAL ELECTRIC	7.28
4	MITSUBISHI CORP.	135.50	4	PHILIP MORRIS	6.30
5	ROYAL DUTCH/SHELL GROUP	134.28	5	GENERAL MOTORS	5.89
6	ITOCHU	131.04	6	IBM	5.86
7	MARUBENI	119.97	7	AT&T	5.61
8	EXXON	116.73	8	INTEL	5.16
9	SUMITOMO CORP.	115.34	9	HSBC HOLDINGS	5.09
10	TOYOTA MOTOR	105.04	10	FORD MOTOR	4.45
SHARE-PRICE GAIN (PERCENTAGE CHANGE FROM 1996 IN U.S. DOLLARS)			RETURN ON EQUITY (PERCENTAGE)		
1	DELL COMPUTER	306%	1	NORTHWEST AIRLINES	536.8%
2	TSIM SHA TSUI PROPERTIES	205	2	GLAXO WELLCOME	164.1
3	AES	159	3	GENERAL MILLS	158.7
4	COMPUWARE	136	4	UST	158.2
5	ADVANCED MICRO DEVICES	127	5	EMI GROUP	152.4
6	HENNES & MAURITZ	123	5	AVON PRODUCTS	132.4
7	COMPAQ COMPUTER	122	7	LUCENT TECHNOLOGIES	92.9
8	CONSECO	120	8	GUCCI GROUP	86.7
9	ALTERA	119	9	SMITHKLINE BEECHAM	77.5
10	RAILTRACK GROUP	118	10	DELL COMPUTER	73.6

DATA: MORGAN STANLEY CAPITAL INTERNATIONAL, BUSINESS WEEK

rating system accounted for much of the rest. The blockbuster Office software suite supplies more than half of Microsoft's \$8.7 billion in annual revenues. In the nine months ended March, earnings rose a breathtaking 46%, to \$9 billion.

Intel is the Microsoft of the global computer business. In 1996, its already powerful lock on the PC microprocessor market became a virtual monopoly. While it stumbled with marketing blunders, it relentlessly churned out a series of faster and faster Pentium chip models, including the first Pentium Pro. Intel's revenues topped \$20 billion for the first time in 1996, and profits came in at more than \$5 billion.

The PC boom explains why Dell Computer Corp. stock rose more than any other in the rankings this year, soaring 122%. The company has perfected the art of ultrahigh asset turnover. Because it custom-builds its PCs after an order is placed, Dell operates with few raw materials and no finished-goods inventory. By collecting payment quickly, it converts a sale to cash on its balance sheet in less than a day. The low-fixed-cost system allows Dell to become more profitable as it grows. Rival Compaq Computer Corp. didn't do badly, either. Its shares were up 122%, bringing the company to No. 83 in the rankings, up from No. 223 last year.

RADICAL CHANGE. Not every American success story was one of technological innovation. Coca-Cola Co. vaulted to second place on the list, from No. 4 last year, boosting its volume around the world and gaining share by virtue of marketing muscle. "What you saw in 1996 was increasing confidence from investors that Coke has won the global wars," says Jennifer F. Solomon of Morgan Brothers Inc. in New York.

Worldwide, unit case volume grew 6%. The surprise was that Coke racked up 16% volume growth in the U.S., where soft-drink market analysts had written it off as mature. Meanwhile, Japanese international numbers remain impressive. Its Middle & Far East group, which has a 42% market share in soft drinks, saw volume growth of 11%. And Greater Europe, volume rose 8% despite the region's slow economic growth. Compared with such achievement, the Japanese made a poor showing overall. The Nikkei stock average, down 6% in the past 12 months, didn't help. Nor did the dollar-yen exchange rate, as the dollar slipped from around 108 to the dollar in midyear 1996 to about 115 now. And although the weaker yen was good for Japanese exporters, making their products cheaper on world markets, domestic demand is still sluggish. Yet companies that have moved out

The Top 100 Companies

Another strong showing by American companies, with 7 out of the top 10 coming from the U.S. this year, including Microsoft and Intel

RANK 1997 1996		MARKET VALUE Billions of U.S. dollars		RANK 1997 1996		MARKET VALUE Billions of U.S. dollars	
1	1	GENERAL ELECTRIC	U.S. 198.09	51	88	NATIONSBANK	U.S. 42.34
2	4	COCA-COLA	U.S. 169.86	52	37	GTE	U.S. 42.14
3	2	ROYAL DUTCH/SHELL	Neth./Britain 168.99	53	36	GENERAL MOTORS	U.S. 41.83
4	3	NTT	Japan 151.57	54	74	BANKAMERICA	U.S. 41.44
5	12	MICROSOFT	U.S. 148.59	55	64	CHASE MANHATTAN	U.S. 40.74
6	6	EXXON	U.S. 147.15	56	90	LUCEENT TECHNOLOGIES	U.S. 40.64
7	15	INTEL	U.S. 124.08	57	44	ENI	Italy 40.08
8	8	TOYOTA MOTOR	Japan 108.67	58	71	DAIMLER-BENZ	Germany 39.74
9	10	MERCK	U.S. 108.49	59	50	MATSUSHITA ELECTRIC INDL.	Japan 39.68
10	9	PHILIP MORRIS	U.S. 106.58	60	41	MOTOROLA	U.S. 39.42
11	42	NOVARTIS	Switzerland 93.48	61	69	MINNESOTA MINING & MFG.	U.S. 38.24
12	18	PROCTER & GAMBLE	U.S. 93.39	62	21	DAI-ICHI KANGYO BANK	Japan 38.03
13	20	IBM	U.S. 85.91	63	67	BOEING	U.S. 37.99
14	11	ROCHE HOLDING	Switzerland 83.51	64	14	FUJI BANK	Japan 37.30
15	5	BANK OF TOKYO-MITSUBISHI	Japan 80.90	65	22	SANWA BANK	Japan 37.10
16	40	HSBC HOLDINGS	Britain 80.71	66	61	AMERITECH	U.S. 35.96
17	13	JOHNSON & JOHNSON	U.S. 79.91	67	62	HITACHI LTD.	Japan 35.52
18	32	BRISTOL-MYERS SQUIBB	U.S. 73.38	68	130	TRAVELERS GROUP	U.S. 35.27
19	26	GLAXO WELLCOME	Britain 70.85	69	58	MCDONALD'S	U.S. 34.77
20	19	WAL-MART STORES	U.S. 67.68	70	91	ING GROEP	Netherlands 34.77
21	25	BRITISH PETROLEUM	Britain 67.34	71	112	L.M. ERICSSON	Sweden 33.85
22	27	PFIZER	U.S. 64.38	72	110	SCHERING-PLOUGH	U.S. 33.20
23	29	AIG	U.S. 63.57	73	108	AMERICAN EXPRESS	U.S. 32.86
24	28	DUPONT	U.S. 61.45	74	93	SONY	Japan 32.34
25	NR	DEUTSCHE TELEKOM	Germany 60.97	75	139	ALLSTATE	U.S. 32.26
26	7	AT&T	U.S. 59.71	76	99	HUTCHISON WHAMPOA	Hong Kong 32.23
27	24	PEPSICO	U.S. 56.31	77	60	SIEMENS	Germany 31.76
28	35	WALT DISNEY	U.S. 55.28	78	75	BELL ATLANTIC	U.S. 30.66
29	30	MOBIL	U.S. 55.03	79	85	HOME DEPOT	U.S. 30.66
30	82	LLOYDS TSB GROUP	Britain 53.85	80	17	INDUSTRIAL BANK OF JAPAN	Japan 30.51
31	65	SBC COMMUNICATIONS	U.S. 53.64	81	104	ORACLE	U.S. 30.47
32	49	BERKSHIRE HATHAWAY	U.S. 52.98	82	80	SEVEN-ELEVEN JAPAN	Japan 30.13
33	48	UNILEVER	Neth./Britain 52.64	83	223	COMPAQ COMPUTER	U.S. 29.68
34	39	CITICORP	U.S. 52.56	84	121	SCHLUMBERGER	U.S. 29.39
35	23	HEWLETT-PACKARD	U.S. 52.53	85	144	BARCLAYS BANK	Britain 29.38
36	52	ELI LILLY	U.S. 51.65	86	86	SUN HUNG KAI PROPERTIES	Hong Kong 29.37
37	77	GILLETTE	U.S. 49.52	87	105	TEXACO	U.S. 28.77
38	31	NESTLE	Switzerland 48.93	88	125	ZENACA GROUP	Britain 28.71
39	56	AMERICAN HOME PRODUCTS	U.S. 48.92	89	97	HONDA MOTOR	Japan 28.60
40	54	ABBOTT LABORATORIES	U.S. 48.73	90	66	BROKEN HILL PROPRIETARY	Australia 28.53
41	47	ALLIANZ	Germany 47.96	91	94	BAYER	Germany 28.13
42	72	SMITHKLINE BEECHAM	Britain 47.32	92	87	UBS	Switzerland 28.13
43	57	FANNIE MAE	U.S. 46.42	93	120	KIMBERLY-CLARK	U.S. 28.12
44	43	CHEVRON	U.S. 45.74	94	79	VEBA	Germany 27.97
45	53	BRITISH TELECOMMS.	Britain 45.55	95	96	DEUTSCHE BANK	Germany 27.77
46	38	BELLSOUTH	U.S. 44.98	96	84	B.A.T. INDUSTRIES	Britain 27.77
47	63	CISCO SYSTEMS	U.S. 44.96	97	34	SINGAPORE TELECOMMS.	Singapore 27.52
48	33	FORD MOTOR	U.S. 44.66	98	192	WARNER-LAMBERT	U.S. 27.41
49	51	AMOCO	U.S. 44.17	99	131	ELF AQUITAINE	France 27.33
50	16	SUMITOMO BANK	Japan 43.40	100	81	EASTMAN KODAK	U.S. 27.27

THE BUSINESS WEEK GLOBAL 1000

COUNTRY RANK	GLOBAL 1000 RANK	MARKET VALUE U.S. \$ MIL	PRICE PER SHARE U.S. \$	% CHANGE FROM 1996 (U.S. \$) (LOCAL)	PRICE/BOOK VALUE RATIO	P/E RATIO	YIELD %	SALES U.S. \$ MIL	PROFITS U.S. \$ MIL	ASSETS U.S. \$ MIL	RETURN ON EQUITY %	INDUSTRY CODE		
9	SOLVAY	720	5062	605	1	13	1.8	16	3.4	8029	318	7442e	11.6g	22
10	ROYALE BELGE	783	4544	284	41	58	2.6	23	2.9	2969	199	26007	11.3	63
11	GROUPE UCB	888	3960	2715	46	64	6.6	24	1.1	1443	162	1362e	26.9g	22
12	ELECTRAFINA	931	3765	101	9	22	1.3	19	4.0	NA	171e	2418e	7.0g	11
13	GROUPE BRUXELLES LAMBERT	935	3752	160	21	35	1.8	17	3.6	NA	220	4571e	10.3g	71
14	CREDIT COMMUNAL HOLDING/DEXIA BELGIUM (7)	NR	3665	100	NA	NA	NA	13	3.3	NA	556	194620	NA	61

BRITAIN

COUNTRY COMPOSITE			1276943	11	26	20	4.3	18	3.6	860617	85702	2988868	24.4	
1	HSBC HOLDINGS	16	80708	31	104	93	3.3	16	2.7	NA	5091	387001	20.6	61
2	GLAXO WELLCOME	19	70854	20	53	45	35.4	22	3.5	13646	3267	13602	164.1	45
3	BRITISH PETROLEUM	21	67343	12	38	31	3.2	16	3.5	73180	4285	53288	19.6	11
4	SHELL TRANSPORT & TRADING (1)	NR	65314	20	39	31	2.7	20	3.8	134281	9310	119832	13.4	11
5	LLOYDS TSB GROUP	30	53851	10	107	96	6.5	20	2.7	NA	2577	211417	32.9	61
6	SMITHKLINE BEECHAM	42	47316	17	69	60	21.1	27	1.9	12965	1693	13108	77.5	45
7	BRITISH TELECOMMUNICATIONS	45	45546	7	31	24	2.2	13	5.6	24434f	3398f	38505	16.3g	55
8	BARCLAYS BANK	85	29378	19	67	58	2.5	12	3.3	NA	2511	304299	20.7	61
9	ZENECA GROUP	88	28714	30	43	35	8.6	26	2.4	8774	1094	8180	32.9	45
10	B. A. T. INDUSTRIES	96	27767	9	11	6	3.1	11	5.9	25721	2536	76630	28.5	71
11	MARKS & SPENCER	124	23465	8	16	10	3.5	19	3.2	12829f	1239f	10388	18.3g	54
12	UNILEVER PLC (2)	NR	21823	27	44	36	5.5	19	2.5	50756	2437	31242e	28.6g	44
13	NATIONAL WESTMINSTER BANK	154	20833	12	26	20	1.8	11	4.9	NA	1904	303210	16.0	61
14	ABBAY NATIONAL	156	20270	14	68	59	2.5	15	3.7	NA	1234	202882	17.2	62
15	GRAND METROPOLITAN	167	19550	9	38	31	3 /	18	3.6	14681	1124	18353	20.4	44
16	PRUDENTIAL	173	19325	10	51	43	4.3	8	3.5	18943	2302	128326	51.2	63
17	REUTERS HOLDINGS	176	18951	11	-3	-9	8.9	23	2.1	4767	803	3825	39.3	52
18	RIO TINTO PLC (3)	NR	18384	17	10	4	3.3	21	3.2	8448	1096	17357	15.9	24
19	CABLE & WIRELESS	189	18148	8	19	13	3.4	16	2.8	9898f	1108f	14757	20.6g	55
20	GUINNESS	192	17944	9	29	22	2.7	16	3.5	7738	1121	13486e	16.6g	43
21	BRITISH SKY BROADCASTING GROUP	215	16135	9	35	28	LOSS	36	1.3	1649	382	799	NA	51
22	GENERAL ELECTRIC CO.	219	15762	6	-1	-6	3.1	15	4.5	17980	1019	10888	20.4	34
23	STANDARD CHARTERED	222	15561	16	59	51	4.5	17	1.9	NA	887	68938	25.5	61
24	BG	232	14738	3	56	47	2.3	14	6.5	7171	1032	19367	16.3	12
25	VODAFONE GROUP	248	13560	4	12	6	8.1	24	2.0	2294	507	2885	34.2	55
26	TESCO	253	13361	6	32	25	2.1	16	3.5	22719f	851f	10834f	13.5	54
27	BTR	257	13267	3	-25	-29	3.6	9	6.1	15593	1461	13499	40.3	71
28	GRANADA GROUP	278	12060	14	11	5	7.6	20	1.9	6244	553	11202	39.0	71
29	BRITISH AIRWAYS	288	11662	12	34	27	2.4	13	2.7	13675f	905f	17073f	18.7	56
30	ROYAL & SUN ALLIANCE INSURANCE GROUP	289	11601	8	22	16	1.2	21	5.2	15313	559	91081	5.7	63
31	BASS	294	11477	13	3	-3	1.8	15	4.0	8358	726	11393	12.0	53
32	REED INTERNATIONAL (5)	NR	11273	10	14	8	6.6	21	2.8	5531	987	8420	30.8	51
33	RENTOKIL INITIAL	313	10997	4	21	15	LOSS	28	1.3	3713	359	2433	NA	52
34	GREAT UNIVERSAL STORES	325	10646	11	1	-5	1.7	17	3.3	4511	632	7862	10.2	54
35	J. SAINSBURY	329	10504	6	-7	-12	1.8	15	4.4	23414f	702f	11050	12.1g	54
36	BOOTS	332	10476	12	23	16	3.1	19	3.4	6750	540	5709	15.9	54
37	NATIONAL POWER	341	10262	9	41	33	2.4	11	5.7	5783f	991f	7869	21.7g	12
38	IMPERIAL CHEMICAL INDUSTRIES	364	9643	13	1	-5	1.7	22	4.9	17211	576	14807	7.5	22
39	BAA	391	9044	9	15	9	1.7	17	2.7	2050	491	7997	10.4	52
40	LEGAL & GENERAL GROUP	396	9005	7	65	56	2.6	14	3.2	5042	651	75061	19.2	63
41	CADBURY SCHWEPPE'S	397	8968	9	20	13	4.6	16	3.9	8368	556	7373	28.4	43
42	BRITISH AEROSPACE	403	8753	20	48	40	3.8	17	1.6	10575	522	12638	22.5	31
43	ASSOCIATED BRITISH FOODS	427	8352	9	58	50	2.1	18	2.1	9337	455	5966	11.4	44
44	EMI GROUP	434	8282	19	-12	-17	33.6	22	3.2	5546f	377f	3832	152.4g	46
45	BOC GROUP	443	8122	17	16	10	2.7	18	3.5	6138	455	7585	15.5	22
46	ROYAL BANK OF SCOTLAND GROUP	450	7995	10	21	15	2.6	13	4.0	NA	617	99986	20.7	61
47	KINGFISHER	455	7846	12	24	17	3.4	17	3.3	9513f	457f	5597f	19.6	54
48	LAND SECURITIES	459	7755	15	51	43	1.3	28	3.7	NA	278f	9318	4.8g	64
49	COMMERCIAL UNION ASSURANCE	464	7677	11	19	13	1.2	15	5.5	13484	479	88954	7.9	63
50	ALLIED DOMECQ	470	7563	7	-3	-8	2.2	13	6.6	8785	561	8870	16.2	43
51	POWERGEN	472	7553	11	43	36	2.3	11	4.5	4671f	702f	6781	20.7g	12
52	BANK OF SCOTLAND	474	7528	6	51	43	2.6	12	2.7	NA	616f	77341f	21.7	61
53	SIEBE	482	7275	16	17	11	3.9	18	1.9	4917f	415f	4820	21.8g	35
54	SCOTTISH POWER	485	7255	6	30	23	2.8	10	6.0	4811f	689f	4680	27.3g	12
55	GENERAL ACCIDENT	497	7142	15	44	36	1.3	9	4.7	7126	818	46215	15.4	63
56	SCOTTISH & NEWCASTLE BREWERIES	506	7040	11	10	4	2.2	16	3.6	4857	376	6337	13.1	53
57	PEARSON	530	6703	12	9	4	10.5	23	3.1	3576	281	3674	45.0	51
58	SAFeway PLC	558	6373	6	7	2	2.1	13	4.9	10781f	482f	5775	15.8g	54
59	PENINSULAR & ORIENTAL STEAM NAVIGATION	560	6351	10	29	22	1.7	16	6.0	11601	398	10372	10.5	58
60	WHITBREAD	563	6334	13	15	9	1.7	16	3.8	4953f	387f	6286f	10.6	53
61	NATIONAL GRID GROUP	566	6320	4	31	24	3.5	10	5.9	2356	634	5227	36.0	12
62	UNITED NEWS & MEDIA	577	6215	13	10	4	LOSS	19	3.8	3257	321	2613	NA	51
63	GKN	586	6115	17	13	7	5.2	16	3.1	5459	374	4093	31.7	38

Merrill Lynch

merrill lynch roi=1464%

Merrill Lynch

ROI=1464%

Return On Investment

LTV Steel Company

ROI=16,995%

LTV Steel

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LTV Steel

The top-of-the-line data warehousing software
will have a positive impact on your
business decision makers

And wait until you see what it does

for your bottom line.

Smart business
decisions.

Even smarter
investment.

A recent International Data Corporation (IDC) study of organizations that have implemented data warehouses reveals an average three-year Return on Investment of 401%! There's no better choice for reaping similar rewards than the SAS Data Warehouse, a data warehousing Product of the Year for two years running.

And the world's only end-to-end warehousing solution for managing, organizing, and exploiting your business data—including data from external sources. Here's what two companies featured in the IDC study have to say:

MERRILL LYNCH ROI=1,464%

For this leader in financial services markets, the SAS Data Warehouse yielded fast payback and measurable benefits. According to John Crawford, VP of Reporting Systems in the Marketing Systems Group, "We've been using SAS software for all of our solutions in terms of our data warehouse implementation, and our return on investment has only grown...it's a broad-scope, well-integrated solution that provides all of our data warehousing needs from one vendor, and there's no other single vendor out there capable of doing that."

LTV STEEL COMPANY ROI=16,995%

As the third largest steel operator in the U.S., they've been using SAS software for data warehousing since long before the term was coined. According to Quality Assurance Senior Analyst Robert Scharl, "SAS software is THE element of our data warehousing solution. It beat everything else for data retrieval...and it would have cost us maybe a half million dollars to bring something else in for a data warehousing system."



SAS Institute Inc.

The Business of Better Decision Making

E-mail: bw@sas.com www.sas.com/dw 919.677.8200

COUNTRY Rank	GLOBAL 1000 RANK	MARKET VALUE U.S. \$ MIL	PRICE PER SHARE U.S. \$	% CHANGE FROM 1996 (U.S. \$) (LOCAL)	PRICE/ BOOK VALUE RATIO	P/E RATIO	YIELD %	SALES U.S. \$ MIL	PROFITS U.S. \$ MIL	ASSETS U.S. \$ MIL	RETURN ON EQUITY %	INDUS COT
9 SOLVAY	720	5062	605	1 13	1.8	16	3.4	8029	318	7442e	11.6g	2
10 ROYALE BELGE	783	4544	284	41 58	2.6	23	2.9	2969	199	26007	11.3	6
11 GROUPE UCB	888	3960	2715	46 64	6.6	24	1.1	1443	162	1362e	26.9g	2
12 ELECTRAFINA	931	3765	101	9 22	1.3	19	4.0	NA	171e	2418e	7.0g	1
13 GROUPE BRUXELLES LAMBERT	935	3752	160	21 35	1.8	17	3.6	NA	220	4571e	10.3g	7
14 CREDIT COMMUNAL HOLDING/DEXIA BELGIUM (7)	NR	3665	100	NA NA	NA	13	3.3	NA	556	194620	NA	6

BRITAIN

COUNTRY COMPOSITE	1276943	11	26	20	4.3	18	3.6	860617	85702	2988868	24.4	
1 HSBC HOLDINGS	16	80708	31	104 93	3.3	16	2.7	NA	5091	387001	20.6	6
2 GLAXO WELLCOME	19	70854	20	53 45	35.4	22	3.5	13646	3267	13602	164.1	4
3 BRITISH PETROLEUM	21	67343	12	38 31	3.2	16	3.5	73180	4285	53288	19.6	1
4 SHELL TRANSPORT & TRADING (1)	NR	65314	20	39 31	2.7	20	3.8	134281	9310	119832	13.4	1
5 LLOYDS TSB GROUP	30	53851	10	107 96	6.5	20	2.7	NA	2577	211417	32.9	6
6 SMITHKLINE BEECHAM	42	47316	17	69 60	21.1	27	1.9	12965	1693	13108	77.5	4
7 BRITISH TELECOMMUNICATIONS	45	45546	7	31 24	2.2	13	5.6	24434f	3398f	38505	16.3g	5
8 BARCLAYS BANK	85	29378	19	67 58	2.5	12	3.3	NA	2511	304299	20.7	6
9 ZENECA GROUP	88	28714	30	43 35	8.6	26	2.4	8774	1094	8180	32.9	4
10 B. A.T. INDUSTRIES	96	27767	9	11 6	3.1	11	5.9	25721	2536	76630	28.5	7
11 MARKS & SPENCER	124	23465	8	16 10	3.5	19	3.2	12829f	1239f	10388	18.3g	5
12 UNILEVER PLC (2)	NR	21823	27	44 36	5.5	19	2.5	50756	2437	31242e	28.6g	4
13 NATIONAL WESTMINSTER BANK	154	20833	12	26 20	1.8	11	4.9	NA	1904	303210	16.0	6
14 ABBEY NATIONAL	156	20270	14	68 59	2.5	15	3.7	NA	1234	202882	17.2	6
15 GRAND METROPOLITAN	167	19550	9	38 31	3.7	18	3.6	14681	1124	18353	20.4	4
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17 REUTERS HOLDINGS	176	18951	11	-3 -9	8.9	23	2.1	4767	803	3825	39.3	5
18 RIO TINTO PLC (3)	NR	18384	17	10 4	3.3	21	3.2	8448	1096	17357	15.9	2
19 CABLE & WIRELESS	189	18148	8	19 13	3.4	16	2.8	9898f	1108f	14757	20.6g	5
20 GUINNESS	192	17944	9	29 22	2.7	16	3.5	7138	1121	13486e	16.6g	4
21 BRITISH SKY BROADCASTING GROUP	215	16135	9	35 28	LOSS	36	1.3	1649	382	799	NA	5
22 GENERAL ELECTRIC CO.	219	15762	6	-1 -6	3.1	15	4.5	17980	1019	10888	20.4	3
23 STANDARD CHARTERED	222	15561	16	59 51	4.5	17	1.9	NA	887	68938	25.5	6
24 BG	232	14738	3	56 47	2.3	14	6.5	7171	1032	19367	16.3	1
25 VODAFONE GROUP	248	13560	4	12 6	8.1	24	2.0	2294	507	2885	34.2	5
26 TESCO	253	13361	6	32 25	2.1	16	3.5	22719f	851f	10834f	13.5	5
27 BTR	257	13267	3	-25 -29	3.6	9	6.1	15593	1461	13499	40.3	7
28 GRANADA GROUP	278	12060	14	11 5	7.6	20	1.9	6244	553	11202	39.0	7
29 BRITISH AIRWAYS	288	11662	12	34 27	2.4	13	2.7	13675f	905f	17073f	18.7	5
30 ROYAL & SUN ALLIANCE INSURANCE GROUP	289	11601	8	22 16	1.2	21	5.2	15313	559	91081	5.7	6
31 BASS	294	11477	13	3 -3	1.8	15	4.0	8358	726	11393	12.0	5
32 REED INTERNATIONAL (5)	NR	11273	10	14 8	6.6	21	2.8	5531	987	8420	30.8	5
33 RENTOKIL INITIAL	313	10997	4	21 15	LOSS	28	1.3	3713	359	2433	NA	5
34 GREAT UNIVERSAL STORES	325	10646	11	1 -5	1.7	17	3.3	4511	632	7862	10.2	5
35 J. SAINSBURY	329	10504	6	-7 -12	1.8	15	4.4	23414f	702f	11050	12.1g	5
36 BOOTS	332	10476	12	23 16	3.1	19	3.4	6750	540	5709	15.9	5
37 NATIONAL POWER	341	10262	9	41 33	2.4	11	5.7	5783f	991f	7869	21.7g	1
38 IMPERIAL CHEMICAL INDUSTRIES	364	9643	13	1 -5	1.7	22	4.9	17211	576	14807	7.5	2
39 BAA	391	9044	9	15 9	1.7	17	2.7	2050	491	7997	10.4	5
40 LEGAL & GENERAL GROUP	396	9005	7	65 56	2.6	14	3.2	5042	651	75061	19.2	6
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42 BRITISH AEROSPACE	403	8753	20	48 40	3.8	17	1.6	10575	522	12638	22.5	3
43 ASSOCIATED BRITISH FOODS	427	8352	9	58 50	2.1	18	2.1	9337	455	5966	11.4	4
44 EMI GROUP	434	8282	19	-12 -17	33.6	22	3.2	5546f	377f	3832	152.4g	4
45 BOC GROUP	443	8122	17	16 10	2.7	18	3.5	6138	455	7585	15.5	2
46 ROYAL BANK OF SCOTLAND GROUP	450	7995	10	21 15	2.6	13	4.0	NA	617	99986	20.7	6
47 KINGFISHER	455	7846	12	24 17	3.4	17	3.3	9513f	457f	5597f	19.6	5
48 LAND SECURITIES	459	7755	15	51 43	1.3	28	3.7	NA	278f	9318	4.8g	6
49 COMMERCIAL UNION ASSURANCE	464	7677	11	19 13	1.2	15	5.5	13484	479	88954	7.9	6
50 ALLIED DOMECQ	470	7563	7	-3 -8	2.2	13	6.6	8785	561	8870	16.2	4
51 POWERGEN	472	7553	11	43 36	2.3	11	4.5	4671f	702f	6781	20.7g	1
52 BANK OF SCOTLAND	474	7528	6	51 43	2.6	12	2.7	NA	616f	77341f	21.7	6
53 SIEBE	482	7175	16	17 11	3.9	18	1.9	4917f	415f	4820	21.8g	3
54 SCOTTISH POWER	485	7255	6	30 23	2.8	10	6.0	4811f	689f	4680	27.3g	1
55 GENERAL ACCIDENT	497	7142	15	44 36	1.3	9	4.7	7126	818	46215	15.4	6
56 SCOTTISH & NEWCASTLE BREWERIES	506	7040	11	10 4	2.2	16	3.6	4857	376	6337	13.1	5
57 PEARSON	530	6703	12	9 4	10.5	23	3.1	3576	281	3674	45.0	5
58 SAFEWAY PLC	558	6373	6	7 2	2.1	13	4.9	10781f	482f	5775	15.8g	5
59 PENINSULAR & ORIENTAL STEAM NAVIGATION	560	6351	10	29 22	1.7	16	6.0	11601	398	10372	10.5	5
60 WHITBREAD	563	6334	13	15 9	1.7	16	3.8	4953f	387f	6286f	10.6	5
61 NATIONAL GRID GROUP	566	6320	4	31 24	3.5	10	5.9	2356	634	5227	36.0	1
62 UNITED NEWS & MEDIA	577	6215	13	10 4	LOSS	19	3.8	3257	321	2613	NA	5
63 GKN	586	6115	17	13 7	5.2	16	3.1	5459	374	4093	31.7	3

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investment.

A recent International Data Corporation (IDC) study of organizations that have implemented data warehouses reveals an average three-year Return on Investment of 401%! There's no better choice for reaping similar rewards than the SAS Data Warehouse, a data warehousing Product of the Year for two years running

And the world's only end-to-end warehousing solution for managing, organizing, and exploiting your business data—including data from external sources. Here's what two companies featured in the IDC study have to say:

MERRILL LYNCH ROI=1,464%

For this leader in financial services markets, the SAS Data Warehouse yielded fast payback and measurable benefits. According to John Crawford, VP of Reporting Systems in the Marketing Systems Group, "We've been using SAS software for all of our solutions in terms of our data warehouse implementation, and our return on investment has only grown...it's a broad-scope, well-integrated solution that provides all of our data warehousing needs from one vendor, and there's no other single vendor out there capable of doing that."

LTV STEEL COMPANY ROI=16,995%

As the third largest steel operator in the U.S., they've been using SAS software for data warehousing since long before the term was coined. According to Quality Assurance Senior Analyst Robert Scharl, "SAS software is THE element of our data warehousing solution. It beat everything else for data retrieval...and it would have cost us maybe a half million dollars to bring something else in for a data warehousing system."



SAS Institute Inc.

The Business of Better Decision Making

COUNTRY	GLOBAL 1000 RANK	MARKET VALUE U.S. \$ MIL.	PRICE PER SHARE U.S. \$	% CHANGE FROM 1996 (U.S. \$) (LOCAL)	PRICE/BOOK VALUE RATIO	P/E RATIO	YIELD %	SALES U.S. \$ MIL.	PROFITS U.S. \$ MIL.	ASSETS U.S. \$ MIL.	RETURN ON EQUITY %	INDUSTRY
64 UNITED UTILITIES	602	6026	11	28	21	1.8	9	6.7	3889f	663f	8943	20.3g
65 ROLLS-ROYCE	606	6014	4	17	11	2.8	20	2.7	7020	306	6428	14.4
66 RANK GROUP	620	5872	7	-11	-16	2.3	18	5.0	3079	329	5638	13.1
67 ASDA GROUP	631	5735	2	8	2	2.1	15	2.9	9885	362	5362	14.6
68 RECKITT & COLMAN	638	5694	14	31	24	4.5	16	3.3	3799	365	4030	27.6
69 SCHROEDERS	662	5489	28	34	27	3.6	19	1.5	NA	293	16966	19.1
70 ENTERPRISE OIL	670	5457	11	50	42	4.1	26	3.2	1656	208	4434	15.6
71 VENDOME LUXURY GROUP	684	5325	8	-22	-26	2.6	17	2.8	2400	316	3024	15.3
72 RAILTRACK GROUP	695	5243	10	118	106	NA	12	4.1	NA	440	NA	NA
73 TOMKINS	701	5186	4	10	4	2.9	13	4.8	5894	366	3801	21.9
74 BLUE CIRCLE INDUSTRIES	714	5099	7	26	20	2.8	18	3.9	2969	283	3969	15.7
75 BRITISH STEEL	718	5079	2	-6	-11	0.7	6	8.2	11531	1271	13322	11.9
76 CARLTON COMMUNICATIONS	731	4987	9	15	9	6.0	16	2.8	2744	299	2218	38.2
77 3I GROUP	753	4806	8	17	11	1.2	38	2.1	NA	115	6709	3.1
78 BRITISH LAND	773	4653	10	54	46	1.4	42	1.8	NA	71	7253	3.3
79 CENTRICA	778	4612	1	NA	NA	1.3	24	NA	7750e	195e	7247	NA
80 NEXT	784	4542	12	39	32	6.6	24	2.5	1549f	189f	1103f	27.4
81 LUCASVARITY	796	4483	3	-17	21	5.1	19	2.9	4373cf	131cf	4902f	26.0
82 TI GROUP	803	4458	9	14	8	8.4	19	3.2	2874	232	2057	44.0
83 SEVERN TRENT	810	4432	13	36	29	1.1	8	4.8	1894	536	6412	13.4
84 LADBROKE GROUP	813	4413	4	28	22	1.6	22	3.4	6257	200	5061	7.1
85 WOLSELEY	827	4318	8	7	1	3.4	15	2.8	7058	266	3416	22.0
86 MERCURY ASSET MANAGEMENT GROUP	829	4295	24	53	45	11.1	23	3.9	NA	191f	2212	49.1g
87 THAMES WATER	847	4177	11	22	16	1.3	9	5.5	1953	488	6119	14.4
88 GUARDIAN ROYAL EXCHANGE	857	4139	5	10	4	1.2	6	4.5	6106	721	30698	21.4
89 ORANGE	867	4057	3	-11	-16	LOSS	-10	0.0	1013	-375	1474	NA
90 LASMO	906	3864	4	42	34	2.1	76	0.8	1225	51	4083	2.8
91 RMC GROUP	911	3854	15	-4	-10	1.7	13	3.6	6678	286	5584	12.4
92 SMITHS INDUSTRIES	913	3847	13	17	11	11.1	20	2.7	1650	181	1162	55.6
93 BURMAH CASTROL	951	3662	17	7	1	3.0	15	4.4	5005	242	3688	20.1
94 COMPASS GROUP	974	3562	11	24	18	LOSS	24	1.7	4191	137	1320	NA
95 MEPC	983	3531	8	30	23	1.2	22	4.9	NA	156	7043	5.1

CANADA

COUNTRY COMPOSITE		239277	33	28	28	2.6	25	1.9	127762	11680	859911	12.6
1 NORTHERN TELECOM	141	21929	84	55	56	4.8	34	0.7	12847	623	10903	14.4
2 BCE (BELL CANADA ENTERPRISES)	203	16760	26	32	33	2.2	23	3.7	20420	745	29913	9.4
3 SEAGRAM	231	14902	40	17	17	1.6	30	1.6	5013b	85b	21628	5.5
4 THOMSON	252	13432	22	36	37	2.9	33	2.6	7723	413	13173	8.8
5 ROYAL BANK OF CANADA	254	13356	43	82	83	2.4	13	2.5	NA	1037	158009	18.2
6 CANADIAN IMPERIAL BANK OF COMMERCE	351	9961	24	46	47	1.8	11	3.0	NA	990	144301	16.7
7 BANK OF MONTREAL	352	9935	38	61	62	2.0	12	3.0	NA	847	123125	17.2
8 BANK OF NOVA SCOTIA	355	9881	42	72	73	2.1	13	2.6	NA	775	114011	16.3
9 BARRICK GOLD	375	9447	25	-20	-19	2.7	39	0.6	1299	256	4515	6.9
10 CANADIAN PACIFIC	382	9218	27	30	31	2.0	16	1.3	6296	537	11031	12.2
11 TORONTO-DOMINION BANK	392	9028	30	68	69	2.1	13	2.7	NA	663	91089	16.2
12 ALCAN ALUMINIUM	442	8144	36	10	10	1.7	20	1.7	7614	410	9325	8.9
13 IMPERIAL OIL	467	7627	49	12	13	2.3	24	3.3	7527	314	7630	9.9
14 BOMBARDIER	500	7123	21	51	51	5.8	24	1.0	5800f	294f	4666	23.8g
15 NEWBRIDGE NETWORKS	524	6818	40	11	12	10.3	37	0.0	668	147	793	28.1
16 IMASCO	557	6434	28	38	39	2.5	15	3.1	6841	436	43317	17.1
17 INCO	660	5496	33	1	2	1.6	48	1.2	3139	168	7642	3.3
18 PANCANADIAN PETROLEUM	666	5464	22	12	13	3.2	19	1.3	2020	251	3590	16.5
19 NORANDA	688	5292	22	3	4	1.6	38	3.3	6898	184	10813	4.2
20 PETRO-CANADA	764	4710	17	34	35	1.8	23	1.3	4065	179	5632	7.6
21 SHELL CANADA	770	4665	41	26	26	1.7	10	3.2	3760	431	4647	16.9
22 PLACER DOME	787	4529	18	-38	-38	2.8	73	1.7	1157	56	2574e	3.9g
23 POTASH CORP. OF SASKATCHEWAN	819	4376	82	21	22	2.7	19	1.3	1404	209	2494	14.2
24 LAIDLAW	831	4267	14	34	35	2.8	38	1.1	1665	82	3576	7.4
25 TRANSCANADA PIPELINES	840	4111	19	34	35	1.8	14	4.3	7823	308	9146	12.7
26 FALCONBRIDGE	898	3894	22	-2	-2	2.5	33	1.3	1555	137	2606	7.5
27 NOVA CORP.	917	3834	8	-13	-13	1.4	12	3.5	3397	312	7285	11.8
28 MAGNA INTERNATIONAL	971	3819	54	11	12	2.2	14	1.6	4246	224	3178	16.3
29 RENAISSANCE ENERGY	966	3607	31	19	20	2.5	25	0.0	691	131	2058	10.1
30 TALISMAN ENERGY	970	3576	33	37	38	2.4	49	0.0	879	69	2720	4.8
31 CANADIAN NATIONAL RAILWAY	980	3541	42	75	76	2.1	9	1.6	3015	366	4521	22.5

DENMARK

COUNTRY COMPOSITE		45933	10695	34	48	10.2	46	1.5	12178	1931	87504	22.2	
1	NOVO-NORDISK	641	8056	107	51	72	3.3	29	0.5	2291	277	3425	11.3
2	DAMPSKIBSSKABET AF 1912	471	7554	34970	59	75	26.5	128	0.3	NA	59	420	23.6g
3	DAMPSKIBSSKABET SVENBORG	475	7462	50068	54	69	23.7	118	0.4	NA	63	399e	20.1g
4	TELE DANMARK	643	6458	49	0	10	1.5	14	5.3	3590	478	7256	11.1

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COUNTRY RANK		GLOBAL 1000 RANK	MARKET VALUE U.S. \$ MIL	PRICE PER SHARE U.S. \$	% CHANGE FROM 1996 (U.S. \$) (LOCAL)	PRICE/BOOK VALUE RATIO	P/E RATIO	YIELD %	SALES U.S. \$ MIL	PROFITS U.S. \$ MIL	ASSETS U.S. \$ MIL	RETURN ON EQUITY %	INDUS. CODE	
5	DEN DANSKE BANK	726	5044	95 ^f	52	68	1.3	9	2.6	NA	562	69595	14.1	6
6	SOPHUS BERENDSEN	878	3994	152	25	38	19.7	29	0.6	1035	140	699	68.7	7
7	CARLSBERG	926	3790	59	5	15	2.9	23	0.9	2768	164	3152	12.6	4
8	DANISCO	971	3574	59	23	35	2.8	17	1.1	2494	187	2559	16.5	4

FINLAND

COUNTRY COMPOSITE			25749	44	35	47	4.0	19	2.4	17721	1125	19652	18.1	
1	NOKIA	166	19600	65	50	64	6.8	27	1.0	7651	592	6474	25.5	3
2	UPM-KYMMENE	582	6149	23	20	30	1.2	12	3.8	10070	533	13178	10.7	2

FRANCE

COUNTRY COMPOSITE		392421	140	11	24	2.6	25	2.7	449885	15459	1912394	10.2	
1 ELF AQUITAINE	99	27331	100	39	54	2.1	23	3.6	40390	1211	42852	9.2	1
2 CARREFOUR	110	25301	658	20	34	7.7	45	1.0	26886	562	13251	17.0	5
3 L'OREAL	113	24583	364	32	47	5.6	38	1.0	10474	647	9961	14.6	4
4 TOTAL	133	22338	92	27	41	2.3	23	3.0	30648	980	27455	10.0	1
5 LVMH MOET HENNESSY LOUIS VUITTON	151	21210	243	0	11	3.7	33	2.2	5405	639	13646	11.1	4
6 AXA-IAP	171	19374	60	6	18	1.6	18	3.3	NA	661	195664	9.0	6
7 ALCATEL ALSTHOM	199	17568	108	19	33	2.9	37	2.4	28135	469	44377e	7.6g	3
8 COMPAGNIE GENERALE DES EAUX	216	16065	123	16	29	2.7	45	2.5	28797	339	41698	6.1	5
9 COMPAGNIE DE SAINT-GOBAIN	282	11987	138	9	21	1.5	16	3.2	15861	750	21863	9.3	2
10 SGS-THOMSON MICROELECTRONICS	299	11325	81	92	113	4.2	21	0.0	4078	626	4486e	20.3g	3
11 L'AIR LIQUIDE	305	11231	154	-3	8	2.7	23	2.4	5968	481	8392	11.7	2
12 GROUPE DANONE	314	10970	151	3	15	1.6	19	2.9	14569	587	17508	8.6	4
13 RHONE-POULENC	323	10693	32	30	45	1.7	22	2.8	14895	476	24619	7.7	2
14 SOCIETE GENERALE	346	10197	111	5	17	1.0	13	4.1	NA	789	308674	8.0	6
15 PINAULT-PRINTEMPS-REDOUTE	376	9409	420	36	51	3.8	26	2.0	13954	358	9961	14.3	5
16 SANOFI	384	9128	87	13	26	2.7	30	2.0	4104	303	6362	8.9	4
17 BANQUE NATIONALE DE PARIS	413	8529	41	10	22	0.9	13	3.4	NA	669	323018	6.7	6
18 COMPAGNIE DE SUEZ	425	8368	51	33	48	1.2	57	4.2	NA	146	42403	2.1	6
19 PARIBAS	449	8009	65	6	18	1.1	11	5.3	NA	755	264256	9.9	6
20 MICHELIN	512	6943	55	9	21	2.4	13	1.6	12366	502	13226	18.5	3
21 GROUPE SCHNEIDER	537	6627	48	4	16	2.1	29	2.7	10698	229	9093	7.1	3
22 CHRISTIAN DIOR	540	6614	157	11	24	1.7	21	2.5	5615	315	19403	8.4	4
23 PROMODES GROUP	551	6496	339	30	45	4.6	30	1.1	17970	216	7841	15.3	5
24 LAFARGE	597	6046	64	-3	8	1.4	19	4.1	6120	320	9464	7.6	2
25 LYONNAISE DES EAUX-DUMEZ	622	5862	98	2	13	2.1	25	3.2	15902	234	27231e	8.4g	5
26 SYNTHELABO	644	5657	117	35	51	6.3	34	1.2	1810	165	1768	18.4	4
27 HAVAS	676	5423	68	-21	-12	2.0	25	3.3	8437	174	6823	8.1	5
28 CANAL PLUS	699	5216	170	31	-23	2.7	30	3.1	2011	140	3757	9.1	5
29 RENAULT	708	5153	21	-21	-12	0.8	-6	0.0	31950	911	38324	NEG	4
30 PSA PEUGEOT CITROEN	734	4966	99	-29	21	0.5	39	0.8	29970	127	25203	1.3	4
31 ACCOR	780	4599	139	-4	7	1.7	25	3.8	4913	184	9622	6.8	5
32 CETELEM	782	4558	107	-2	9	2.8	20	2.4	NA	228	15692	13.9	6
33 LEGRAND	792	4497	161	-9	2	4.3	28	1.3	1996	161	2963	15.2	3
34 VALEO	848	4171	59	13	26	2.3	20	0.9	5011	208	4285	11.5	3
35 AGF	854	4147	30	14	27	1.0	16	4.3	12037	267	72031	6.5	6
36 BIC	866	4079	148	29	44	4.8	34	1.9	1102	120	1315	14.1	4
37 USINOR SACLOR	954	3656	15	-6	4	0.8	14	5.2	12334	258	12003	6.0	2
38 ERIDANIA BEGHIN-SAY	958	3644	140	-10	0	1.2	12	6.1	9542	301	8621	9.7	4
39 CASINO, GUICHARD-PERRACHON	990	3519	45	11	24	2.5	25	2.6	11602	145	5778	10.0	5
40 SODEXHO ALLIANCE	994	3497	465	20	34	4.6	49	1.5	4332	70	2886	9.4	5
41 DEXIA FRANCE (7)	NR	3435	94	19	32	NA	12	4.4	NA	556	194620	NA	6

GERMANY

COUNTRY COMPOSITE		605103	255	26	40	4.0	31	2.1	642221	21266	2634776	13.6		
1	DEUTSCHE TELEKOM	25	60969	22	NA	NA	2.1	34	2.3	36982	1031	102210	6.4	5
2	ALLIANZ	41	47960	212	28	43	6.0	41	0.7	34160e	888e	168470e	14.4	6
3	DAIMLER-BENZ	58	39738	77	41	58	2.6	25	1.2	62349	1619	65938	10.4	4
4	SIEMENS	77	31761	56	1	13	2.4	22	2.2	55220	1336	51304	11.0	3
5	BAYER	91	28132	39	16	30	2.5	17	3.7	28500	1598	28992	14.4	2
6	VEBA	94	27968	57	8	21	2.6	19	2.8	39926	1441	42168	13.4	1
7	DEUTSCHE BANK	95	27772	56	18	32	1.7	22	2.7	NA	1251	519533	7.4	6
8	BASF	129	22830	37	33	49	2.1	14	3.9	28598	1636	25633	14.3	2
9	HOECHST	130	22787	39	17	30	2.8	24	3.0	29860	1239	32321	11.8	2
10	VOLKSWAGEN	136	22269	647	84	105	3.6	20	1.2	58704	386	55448	18.0	4
11	RWE	140	21950	43	8	21	5.5	25	2.9	38367	701	44428	22.4	1
12	MUENCHENER RUECK.	153	20872	2551	44	61	8.1	31	0.5	15374	292	74381	26.1	6
13	SAP	180	18619	179	31	46	22.2	76	0.8	1581e	236e	1300e	29.1	5
14	DRESDNER BANK	210	16387	35	41	57	2.0	21	3.5	NA	901	323588	9.5	6
15	BMW	213	16221	820	49	67	3.2	29	1.5	30644	481	26585	11.1	4
16	MANNESMANN	230	14973	407	17	31	4.1	32	1.3	20335	225	14107	12.9	3

TEMPLETON

TEMPLETON GLOBAL SMALLER COMPANIES FUND

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CUMULATIVE TOTAL RETURNS*		AVERAGE ANNUAL TOTAL RETURNS*		
10-YEAR	5-YEAR	1-YEAR	5-YEAR	10-YEAR
147.9%	74.9%	9.8%	11.8%	9.5%

■ In today's global market, many investors desire to explore new opportunities that go beyond conventional, broad-appeal mutual funds. The Templeton Global Smaller Companies Fund strives to uncover the best bargains anywhere in the world which other investors may have overlooked. The fund seeks:

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UNDERVALUED AND UNDERFOLLOWED BARGAIN STOCKS

LONG-TERM CAPITAL GROWTH POTENTIAL

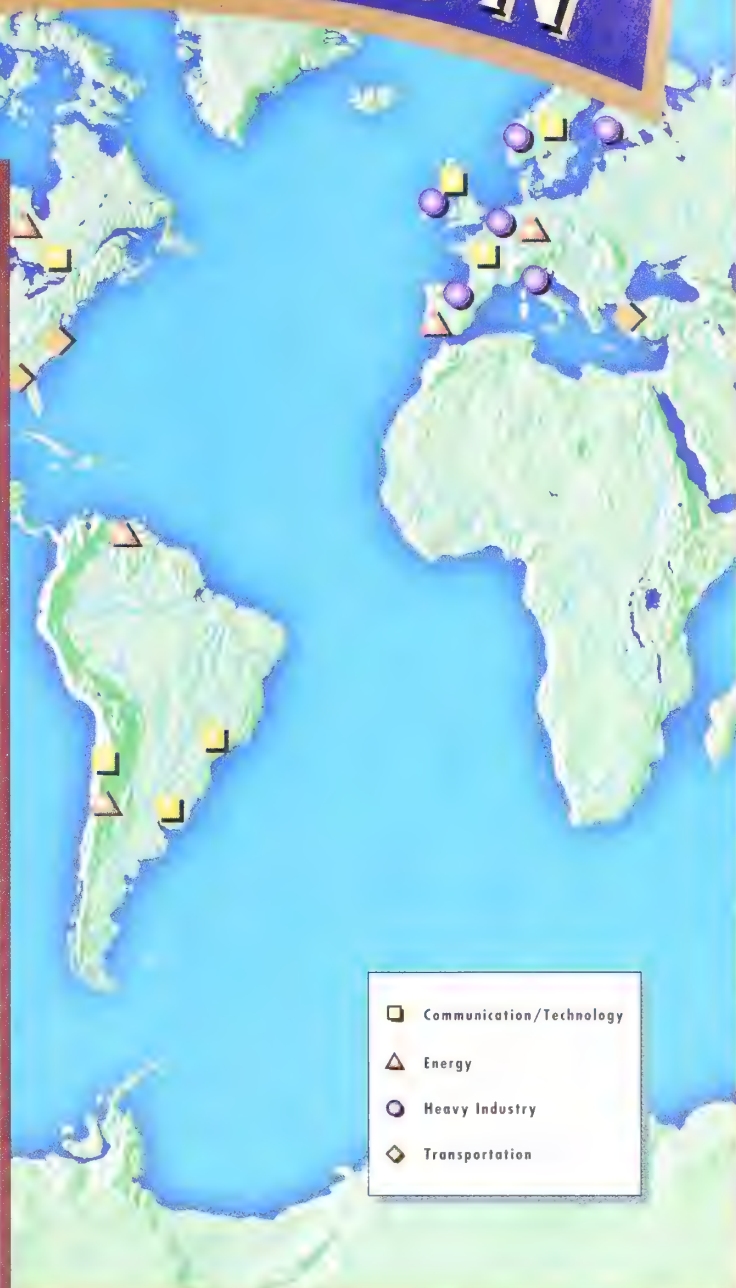
■ The fund's diversified portfolio can help reduce risk, but there are special risks inherent in foreign investing, including currency fluctuation and political uncertainty.

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*Performance figures shown pertain only to Class I shares of the fund. The fund offers other share classes, which are subject to different fees and expenses which will affect their performance. Please see the prospectus for more information.

Cumulative total returns show the percent change in value of an investment and average annual total returns represent the average annual increase in value of an investment over the indicated periods, ended 3/31/97. All calculations have been restated to reflect the current maximum 5.75% initial sales charge and assume reinvestment of dividends and capital gains at net asset value. Such restatement may change actual total returns. Effective January 1, 1993, the fund implemented a Rule 12b-1 plan, which affects subsequent performance. Investment return and principal value will fluctuate so that your shares, when redeemed, may be worth more or less than their original cost. Past performance does not guarantee future results.

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COUNTRY RANK		GLOBAL 1000 RANK	MARKET VALUE U.S. \$ MIL	PRICE PER SHARE U.S. \$	% CHANGE FROM 1996 (U.S. \$) (LOCAL)	PRICE/ BOOK VALUE RATIO	P/E RATIO	YIELD %	SALES U.S. \$ MIL	PROFITS U.S. \$ MIL	ASSETS U.S. \$ MIL	RETURN ON EQUITY %	INDUS. CO.	
17	VIAG	277	12112	456	17	31	2.6	21	2.2	24891	468	28431	12.5	1
18	COMMERZBANK	286	11782	29	41	58	1.6	17	3.8	NA	698	262674	9.7	6
19	METRO	311	11028	110	NA	NA	4.0	NA	1.5	NA	NA	11023	NA	5
20	BAYERISCHE VEREINSBANK	317	10906	41	46	63	2.0	25	3.3	NA	509	235656	7.9	6
21	BAYERISCHE HYPOTHEKEN- UND WECHSEL-BANK	437	8176	32	26	41	1.7	21	3.8	NA	392	198843	8.0	6
22	HENKEL	454	7896	52	NA	NA	3.3	24	1.9	9558	261	7883	13.8	2
23	THYSSEN	501	7121	227	23	37	2.6	24	3.0	22675	175	14941	10.6	2
24	MERCK KGAA	503	7085	41	9	22	5.1	42	2.0	3675e	208e	4465e	12.1	4
25	SCHERING	515	6876	101	34	49	3.5	32	1.7	3091	212	4699	10.8	4
26	FRESENIUS MEDICAL CARE	549	6499	86	NA	NA	3.0	149	0.0	3053	44	5093	2.0	5
27	DEUTSCHE LUFTHANSA	593	6088	16	3	15	2.2	14	2.1	11668e	860e	10799e	16.0	5
28	VEW	608	6004	300	0	12	6.3	31	2.7	5011e	133e	7667e	20.2	1
29	LINDE	626	5791	689	7	20	2.5	27	2.1	5160	211	4876	9.5	3
30	GEHE	705	5172	71	10	23	4.6	37	1.2	11232e	119e	3635e	12.4	4
31	BANKGESELLSCHAFT BERLIN	729	5006	23	6	19	1.1	16	4.0	NA	267e	163808e	6.6	6
32	ADIDAS	755	4773	105	40	57	9.0	23	0.9	2761	184	1440	39.4	4
33	DEGUSSA	795	4483	49	42	58	3.8	21	1.6	8087	171	4807	17.8	2
34	BEIERSDORF	797	4482	53	16	30	4.9	35	1.6	3388	134	2137	14.2	4
35	AACHENER UND MUENCHENER BETEILIGUNG	801	4472	928	45	61	3.7	50	1.4	NA	122e	47682e	7.4	6
36	FRESENIUS	809	4433	222	30	45	5.5	55	0.7	2131	68	4318	10.0	4
37	MAN	844	4181	287	11	24	2.1	19	3.3	11885	177	7622	11.4	3
38	HEIDELBERGER ZEMENT	859	4128	94	43	59	3.4	24	1.4	3541e	147e	5328e	14.6	2
39	PREUSSAG	876	4019	264	3	16	2.4	26	3.2	14684	147	8908	9.2	7
40	LAHMEYER	896	3903	43	21	35	NA	NA	NA	NA	NA	NA	NA	3
41	FRIED. KRUPP AG HOESCH-KRUPP	902	3879	185	18	31	2.5	12	1.7	13799e	222e	10230e	20.3	2
42	ALTANA INDUSTRIE-AKTIE UND ANLAGEN	967	3604	924	47	64	5.5	37	1.4	1334	73	1405	14.9	4

HONG KONG

COUNTRY COMPOSITE		258749	6	30	30	3.4	22	2.6	30164	13566	221075	16.4		
1	HUTCHISON WHAMPOA	76	32232	8	30	30	3.4	19	2.3	4732	1551	16981	17.4	7
2	SUN HUNG KAI PROPERTIES	86	29374	12	21	21	2.1	19	2.5	2919	1425	17867	11.3	6
3	HONG KONG TELECOMMUNICATIONS	107	25881	2	19	20	8.8	18	4.5	4204f	1443f	4718	48.8g	5
4	CHEUNG KONG HOLDINGS	123	23499	10	38	38	3.4	13	1.7	1704	1776	9432e	25.3g	6
5	HANG SENG BANK	127	23183	12	15	15	4.3	21	3.3	NA	1095	50185	20.1	6
6	HENDERSON LAND DEVELOPMENT	202	16879	10	31	31	3.0	13	2.8	NA	1079	10159	22.8	6
7	SWIRE PACIFIC	256	13299	8	-6	5	1.0	14	2.7	4950	920	16305	7.1	7
8	CHINA LIGHT & POWER	269	12460	5	5	5	2.6	19	3.7	2403	624	4430	13.5	1
9	CITIC PACIFIC	274	12196	6	40	41	2.6	27	1.4	1646	460	6448	9.8	7
10	NEW WORLD DEVELOPMENT	279	12059	6	34	34	1.7	20	2.4	NA	537	12384	8.6	6
11	WHARF (HOLDINGS)	340	10303	4	16	16	1.0	29	3.2	1085	353	13431e	3.5g	6
12	HONGKONG ELECTRIC HOLDINGS	483	7275	4	12	13	3.3	14	4.4	990	536	4293	24.1	1
13	CHEUNG KONG INFRASTRUCTURE HOLDINGS	496	7142	3	NA	NA	NA	38	0.7	392	114	NA	NA	2
14	HONG KONG & CHINA GAS	571	6256	2	32	32	4.0	25	2.6	619	251	2411	16.2	1
15	CATHAY PACIFIC AIRWAYS	706	5168	2	-19	-19	1.6	12	4.6	4179	422	8665	12.9	5
16	WHELOCK & CO.	736	4949	2	21	21	1.0	22	2.2	NA	317	6021	4.4	7
17	BANK OF EAST ASIA	751	4821	4	24	24	3.2	20	2.8	NA	243	14591	16.1	6
18	TSIM SHA TSUI PROPERTIES	769	4673	4	205	205	14.7	60	0.7	340	77	4740	24.5	6
19	DAO HENG BANK GROUP	968	3587	5	37	37	3.0	14	2.0	NA	194	13355	20.9	6
20	SINO LAND	992	3514	1	15	15	0.9	18	2.4	NA	148	4662	5.2	6

IRELAND

COUNTRY COMPOSITE		18145	17	32	37	4.2	18	1.8	3902	1084	74839	21.7		
1	BANK OF IRELAND	698	5219	11	53	61	2.8	14	2.5	NA	380f	31648	20.6g	6
2	ALLIED IRISH BANKS	700	5204	8	41	49	2.7	13	3.0	NA	392	38718	20.4	6
3	ELAN	887	3968	41	30	30	8.4	31	0.0	236d	87d	719	27.2	4
4	CRH	934	3753	10	4	10	3.0	16	1.6	3666	225	3754	18.6	2

ITALY

COUNTRY COMPOSITE			170479	5	5	15	3.9	22	2.4	165244	9068	623189	14.0	
1	ENI	57	40076	5	5	15	3.2	15	2.8	34076	2630	52460e	20.9g	1
2	STET	112	25071	5	55	70	2.7	26	1.5	23952	1024	44170e	10.5g	5
3	TIM	135	22281	3	37	50	27.7	44	1.0	4343	550	3810	63.0	5
4	TELECOM ITALIA	147	21645	3	36	49	1.7	18	2.7	17364	1252	34031	9.7	5
5	ASSICURAZIONI GENERALI	229	15033	17	-21	-14	2.6	37	1.3	18205e	411e	74697e	7.2	6
6	FIAT GROUP	245	13870	3	-6	3	1.3	12	1.8	46105	1401	60098e	11.1g	4
7	ISTITUTO NAZIONALE DELLE ASSICURAZIONI	656	5533	1	-8	0	0.8	19	2.8	3931	299	25436e	4.4g	6
8	ISTITUTO MOBILIARE ITALIANO	694	5261	9	7	17	1.2	13	3.7	NA	390	47252	8.6	6
9	ISTITUTO BANCARIO SAN PAOLO DI TORINO	710	5136	6	4	13	0.9	14	2.6	NA	356	154994	6.2	6
10	MEDIASET	719	5073	4	NA	NA	2.5	19	2.7	1852	263	3197	13.2	5
11	ALLEANZA ASSICURAZIONI	808	4438	6	-20	-12	5.0	27	1.4	1117e	91e	9267e	18.7g	6
12	BANCA COMMERCIALE ITALIANA	978	3549	2	-6	3	0.7	16	4.9	NA	223	94031e	4.5g	6
13	MONTEDISON	991	3514	1	-25	-18	0.8	20	1.9	14298	176	19746e	3.8g	7

ENTRY RANK		GLOBAL 1000 RANK	MARKET VALUE U.S. \$ MIL	PRICE PER SHARE U.S. \$	% CHANGE FROM 1996 (U.S. \$) (LOCAL)	PRICE/ BOOK VALUE RATIO	P/E RATIO	YIELD %	SALES U.S. \$ MIL	PROFITS U.S. \$ MIL	ASSETS U.S. \$ MIL	RETURN ON EQUITY %	INDUSTRY CODE
JAPAN													
JAPAN COMPOSITE		2166929	21	-9	-2	3.1	44	0.8	2604592	31077	8262648	6.6	
1	NIPPON TELEGRAPH & TELEPHONE	4	151569	9525	31	41	3.9	118	0.5	75689f	1286f	116685	3.3g 55
2	TOYOTA MOTOR	8	108665	29	25	35	2.4	33	0.6	105037f	3312f	97335	7.2g 42
3	BANK OF TOKYO-MITSUBISHI	15	80898	17	-27	21	3.4	231	0.4	NA	350f	456717	1.5g 61
4	SUMITOMO BANK	50	43397	14	-30	-24	2.6	149	0.5	NA	292f	455958	1.8g 61
5	MATSUSHITA ELECTRIC INDUSTRIAL	59	39676	19	9	18	1.4	34	0.6	65871f	1183f	68753	4.0g 41
6	DAI-ICHI KANGYO BANK	62	38028	12	-32	-27	2.2	-25	0.6	NA	-1522f	473530	NEG 61
7	FUJII BANK	64	37299	13	41	-36	2.7	40	0.6	NA	936f	466845	6.7g 61
8	SANWA BANK	65	37100	13	-34	-28	2.3	167	0.6	NA	222f	456971	1.4g 61
9	HITACHI LTD.	67	35518	11	15	24	1.3	47	0.9	73114f	758f	84128	2.8g 34
0	SONY	74	32342	84	32	43	3.1	29	0.5	39411	466	43300	10.9 41
1	INDUSTRIAL BANK OF JAPAN	80	30511	12	-51	-48	2.3	279	0.6	NA	109f	372866f	0.8g 61
2	SEVEN-ELEVEN JAPAN	82	30126	72	19	28	10.4	60	0.5	12676	459	4034	17.4g 54
3	HONDA MOTOR	89	28595	29	22	32	2.9	15	0.4	45396f	1898f	30173	19.3g 42
4	TOKYO ELECTRIC POWER	108	25773	19	-24	-18	2.0	58	2.3	43370	445	120732	3.5 12
5	mitsubishi heavy industries	116	24254	7	-16	-10	2.3	23	1.2	26946f	1061f	35810	9.8g 38
6	ITO-YOKADO	120	23669	57	0	8	3.3	37	0.5	25916f	638f	14759	8.9g 54
7	NOMURA SECURITIES	126	23246	12	-37	-32	1.6	-11	0.7	NA	-2083f	119863	NEG 62
8	FUJITSU	132	22441	12	34	45	2.3	57	0.7	38617f	396f	37111	4.0g 33
9	SEIBU RAILWAY	134	22310	51	-3	5	86.2	-463	0.1	4765	-48	10681	NEG 57
0	TAKEDA CHEMICAL INDUSTRIES	137	22169	25	53	65	3.7	36	0.6	7198f	613f	10060	10.2g 45
1	DENSO	139	22006	25	16	25	2.6	36	0.4	13902f	613f	14604f	7.3 37
2	CANON	144	21778	25	29	39	2.6	27	0.4	21953	808	22469	9.6 33
3	NEC	145	21766	14	26	36	2.9	28	0.7	42478f	786f	40188	10.3g 34
4	SAKURA BANK	155	20481	6	-45	-41	1.4	135	1.2	NA	152f	436001	1.1g 61
5	NIPPON STEEL	157	20162	3	-14	-7	2.6	681	0.7	26259f	30f	38851	0.4g 25
6	FUJI PHOTO FILM	159	19917	39	25	34	1.9	27	0.5	10727f	732f	15849	6.8g 46
7	TOSHIBA	162	19751	6	-12	-5	1.9	34	1.4	46769f	576f	47717	5.6g 34
8	EAST JAPAN RAILWAY	163	19737	4934	-10	-3	3.2	33	0.9	21540f	606f	63370f	9.8 57
9	MITSUBISHI TRUST & BANKING	178	18663	14	-14	7	3.0	194	0.4	NA	96f	148513	1.5g 62
0	MITSUBISHI CORP.	182	18425	12	-14	7	1.8	48	0.6	135502f	381f	84403	3.8g 59
1	KANSAI ELECTRIC POWER	183	18392	19	-18	-11	1.8	34	2.3	22145	534	58535	5.1 12
2	TOKIO MARINE & FIRE	187	18219	12	-9	-2	3.4	80	0.6	10972	229	43082	4.3 63
3	BRIDGESTONE	190	18145	23	30	40	3.4	30	0.5	16820	604	15121	11.4 37
4	MITSUBISHI ES&TE	194	17727	14	-2	5	5.1	-21	0.5	4731	-849	18462	NEG 64
5	TOKAI BANK	206	16681	8	-34	-29	2.0	-14	0.9	NA	-1155	284346	NEG 61
6	NISSAN MOTOR	207	16648	7	-19	-13	1.4	25	0.9	56638f	667f	60856	5.7g 42
7	DDI	214	16212	7457	-14	-7	10.8	-72	0.2	8722f	-224f	9059f	NEG 55
8	JAPAN TOBACCO	225	15292	7646	11	4	1.4	21	0.8	32352f	742f	17958	6.9g 43
9	ASAHI BANK	226	15171	7	-46	-41	1.8	121	0.9	NA	126f	253850	1.5g 61
0	DAI NIPPON PRINTING	228	15075	20	8	17	2.2	31	0.7	11242f	482f	11471	7.2g 52
1	SHARP	236	14500	13	-21	-15	1.9	35	0.8	15361f	417f	17224	5.4g 41
2	SANKYO	240	14365	32	34	44	4.3	38	0.6	4783	378	6027	11.4 45
3	mitsui & co.	244	13946	9	-4	4	2.7	45	0.8	140136f	311f	63147	6.0g 59
4	CHUBU ELECTRIC POWER	249	13523	18	-22	-16	1.7	33	2.4	18098	410	52330	5.1 12
5	KYOCERA	251	13461	72	5	13	2.4	34	0.7	6134f	392f	8287	6.8g 35
6	MITSUBISHI ELECTRIC	276	12161	6	17	11	1.7	166	1.5	32009f	73f	32124	1.0g 34
7	ROHM	281	12017	104	66	79	4.7	31	0.2	2555f	391f	3943	15.2g 35
8	SUMITOMO ELECTRIC INDUSTRIES	296	11403	16	15	24	2.9	41	0.6	10813f	276f	10703	7.1g 37
9	ASAHI GLASS	297	11396	10	-19	-13	2.2	55	0.8	11499f	207f	14466	4.0g 26
0	NINTENDO	309	11063	78	6	14	2.5	20	1.1	3589f	562f	5577	12.8g 46
1	SUMITOMO TRUST & BANKING	312	10998	9	-36	31	1.9	176	0.7	NA	62f	131244	1.1g 62
2	JUSCO	319	10843	34	14	23	4.1	36	0.6	19223f	303f	11877	11.5g 54
3	KIRIN BREWERY	337	10387	10	-20	-14	1.6	35	1.0	13699	295	13088	4.6 43
4	mitsui fudosan	342	10250	13	0	7	2.1	-27	0.5	10905f	-378	29944	NEG 64
5	TDK	345	10218	77	35	45	2.9	20	0.6	5327f	517f	5358	14.8g 35
6	DAIWA SECURITIES	353	9888	7	-45	-41	1.2	-14	0.9	NA	-687f	60734	NEG 62
7	KINKI NIPPON RAILWAY	362	9720	6	-19	-13	5.6	433	0.7	7841	22	13154	1.3 57
8	TOPPAN PRINTING	365	9602	14	4	4	1.9	52	0.9	10898f	186f	9665	3.6g 52
9	KAWASAKI STEEL	368	9543	3	-21	-15	2.3	140	0.9	10555f	68f	19022	1.6g 25
0	TORAY INDUSTRIES	369	9525	7	1	8	2.4	48	0.9	9011f	200f	11256	5.0g 22
1	ALL NIPPON AIRWAYS	372	9471	7	-39	-34	8.1	-129	0.4	8301	-74	11460	NEG 56
2	MURATA MFG.	373	9463	40	8	16	2.3	34	0.4	2837f	280f	5533f	6.7 35
3	SUMITOMO CORP.	377	9409	9	-20	-14	1.5	-8	0.8	115335f	-1250f	46158	NEG 59
4	NTT DATA COMMUNICATIONS SYSTEMS	380	9271	36643	19	28	6.0	76	0.2	5248f	122f	6986	7.9g 52
5	MITSUI TRUST & BANKING	394	9008	8	-32	-26	1.9	185	0.6	NA	49f	121136	1.0g 62
6	SHIN-ETSU CHEMICAL	401	8759	25	26	36	3.1	25	0.3	5358f	348f	6081	12.3g 22
7	NIKKO SECURITIES	404	8726	6	-46	-42	1.2	-9	1.2	NA	-1001f	32717	NEG 62
8	RICOH	406	8631	13	30	40	2.5	46	0.8	9551	188	12945	5.4 33

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COUNTRY RANK		GLOBAL 1000 RANK	MARKET VALUE U.S. \$ MIL	PRICE PER SHARE U.S. \$	% CHANGE FROM 1996 (U.S. \$) (LOCAL)	PRICE/ BOOK VALUE RATIO	P/E RATIO	YIELD %	SALES U.S. \$ MIL	PROFITS U.S. \$ MIL	ASSETS U.S. \$ MIL	RETURN ON EQUITY %	INDUS- TRY CODE	
69	TAISHO PHARMACEUTICAL	409	8600	25	12	21	3.2	30	0.7	2040f*	287f*	3428*	10.5g	41
70	TOHOKU ELECTRIC POWER	411	8588	17	-25	-19	1.6	26	2.5	13127	334	32021	6.3	17
71	FANUC	415	8523	36	-9	-2	2.1	33	0.5	1577f	262f	4597	6.3g	31
72	MATSUSHITA ELECTRIC WORKS	417	8517	11	4	12	1.8	32	1.0	10232	267	11354	5.7	2
73	SECOM	426	8356	72	11	20	3.7	41	0.7	2416	200	3768	8.9	50
74	NIPPON EXPRESS	428	8343	8	-22	-16	3.4	35	0.8	15361f	236f	9301	9.7g	5
75	KYUSHU ELECTRIC POWER	429	8342	18	-27	-21	1.5	21	2.4	12283	389	35438	7.1	17
76	TOKYO ELECTRON	432	8296	50	80	94	5.4	32	0.5	3714f	257f	3433	16.6g	31
77	SANYO ELECTRIC	435	8221	4	-29	-24	1.2	54	1.0	15361f	152f	21131	2.2g	41
78	JAPAN TELECOM	439	8171	19737	-6	1	3.5	37	0.3	3225f*	218f*	4288*	9.4g	50
79	KAO	441	8149	14	2	10	2.5	34	0.9	7735f	237f	6926f	7.3	44
80	ASAHI CHEMICAL INDUSTRY	447	8022	6	-23	-17	2.1	37	0.9	11070f	218f	10735f	5.7	29
81	SUMITOMO METAL INDUSTRIES	448	8017	3	-17	-11	1.8	35	1.0	12529f	228f	21041	5.1g	29
82	YAMANOUCHI PHARMACEUTICAL	451	7987	25	14	23	2.1	22	0.7	3902f	359f	6751	9.4g	41
83	LONG-TERM CREDIT BANK OF JAPAN	457	7803	3	-60	-57	0.9	47	1.6	NA	167f	279256	1.9g	61
84	SHIZUOKA BANK	460	7737	10	-26	-20	2.0	45	0.5	NA	171f*	66042*	4.4g	61
85	TONEN	468	7585	12	-17	-10	2.9	88	1.7	5709	86	5989e	3.3g	11
86	KOMATSU	469	7581	8	-21	-15	1.5	49	0.9	9440f	156f	13670	3.0g	38
87	JAPAN AIRLINES	473	7541	4	-47	-43	3.3	-97	0.0	12435	-78	18116	NEG	50
88	WEST JAPAN RAILWAY	476	7483	3742	NA	NA	2.9	24	1.2	10384f	306f	22114	12.0g	5
89	ITOCHU	486	7253	5	-29	-24	1.9	68	1.0	131039f	107f	60335	2.7g	50
90	TOKYO GAS	494	7162	3	-33	-27	2.0	50	1.7	8227	144	14221	4.1	17
91	SEKISUI HOUSE	509	6984	10	-17	-10	1.1	19	1.6	12272f	366f	14704	5.6g	31
92	NKK	513	6924	2	-33	-28	1.8	48	1.3	16133f	143f	22615f	3.7g	29
93	MARUI	517	6859	19	-9	-2	2.0	42	1.0	4639f	162f	6271	4.7g	50
94	MITSUBISHI MOTORS	523	6819	7	-12	-5	1.6	69	0.8	31494f	100f	25811	2.4g	41
95	SUMITOMO CHEMICAL	529	6708	4	-17	-11	2.9	36	1.0	8681f	184f	11445	8.1g	29
96	MITSUBISHI CHEMICAL	534	6656	3	-39	-34	1.6	34	0.9	14142	193	17035	4.5	27
97	OSAKA GAS	536	6639	3	-33	-27	2.1	53	1.6	6614	125	10335	4.0	17
98	CHUGOKU ELECTRIC POWER	543	6559	18	-22	-16	1.7	27	2.4	8979	244	23830	6.3	17
99	AJINOMOTO	548	6516	10	-17	-10	2.0	50	0.9	6766f	132f	6673	4.1g	44
100	ACOM	552	6480	44	7	16	3.0	20	0.7	NA	316f*	10765f*	14.5	61
101	KUBOTA	553	6472	5	-31	-26	2.3	26	1.1	9783f	248f	11469	8.8g	38
102	MARUBENI	562	6346	4	-22	-16	1.3	37	1.2	119969f	173f	65597	3.6g	50
103	TOKYU CORP.	569	6277	6	-24	-18	3.2	366	0.8	4154	17	13553	0.9	50
104	NIKON	572	6254	17	38	49	4.9	39	0.4	2856	159	3648	12.5	31
105	DAIWA BANK	574	6234	4	-47	-43	1.2	25	1.3	NA	-253f	145312	NEG	61
106	NIPPON OIL	575	6227	5	-23	-17	1.1	58	1.2	22827f	108f	23741	2.0g	17
107	DAIWA HOUSE INDUSTRY	580	6159	12	-23	-17	1.3	18	1.2	9150	335	10651	7.6	31
108	ADVANTEST	585	6126	68	69	83	5.9	29	0.3	1384f	212f	1646	20.3g	31
109	TOYODA AUTOMATIC LOOM WORKS	590	6103	22	7	16	2.7	40	0.6	4787f	154f	3900	6.7g	38
110	ASAHI BREWERIES	603	6024	14	15	24	2.2	85	0.6	10384	71	14565	2.6	44
111	SHISEIDO	605	6017	15	18	27	1.9	37	0.7	5051f	164f	4982	5.2g	44
112	KAWASAKI HEAVY INDUSTRIES	607	6008	4	-17	-11	4.0	31	1.2	10469f	194f	10747	13.0g	38
113	MATSUSHITA COMMUNICATION INDUSTRIAL	611	5974	32	23	33	2.9	24	0.4	6988f	246f	4200f	12.1	31
114	OJI PAPER	612	5954	6	-34	-29	1.4	54	1.4	9697f	111f	8773	2.7g	27
115	TOSTEM	624	5844	27	-9	-2	2.0	30	0.6	4911	193	5541	6.5	27
116	SEKISUI CHEMICAL	633	5731	10	-12	-5	1.7	26	0.9	9225	225	7791	6.5	27
117	MATSUSHITA-KOTOBUKI ELECTRONICS INDUSTRIES	641	5673	36	44	55	3.3	31	0.3	5334f	181f	3324f	10.4	41
118	BANK OF YOKOHAMA	646	5645	5	-42	-38	1.5	518	0.9	NA	11f	104127	0.3g	61
119	SUZUKI MOTOR	649	5625	13	-1	7	2.1	20	0.5	12872f	288f	8175	10.5g	41
120	EISAI	652	5579	20	10	18	2.8	33	0.8	2416f	167f	3301	8.3g	41
121	TOYO TRUST & BANKING	653	5578	7	-26	-20	1.6	-8	0.6	NA	-671	64869	NEG	61
122	YASUDA FIRE & MARINE	664	5473	6	-17	-11	2.6	61	1.0	7812	90	31323	4.2	61
123	KOBE STEEL	674	5450	2	-30	-25	1.8	36	0.0	13130f	150f	20349	5.0g	27
124	KEYENCE	675	5443	144	21	30	5.6	57	0.1	421	96	1085	9.8	31
125	HACHIJUNI BANK	677	5420	9	-15	-8	2.5	46	0.5	NA	117f*	46994*	5.4g	61
126	KAJIMA	680	5370	6	-47	-42	1.6	85	1.4	18021f	63f	24731	1.9	31
127	HOYA	690	5272	45	41	52	4.7	40	0.4	1660f	131f	1747	11.7g	41
128	OMRON	692	5263	20	-1	7	2.0	39	0.6	5100f	135f	4984	5.2g	31
129	NICHIEI	696	5242	94	37	48	5.9	25	0.6	NA	209f	3765	23.6g	61
130	SMC	707	5159	82	4	12	4.6	35	0.2	1449f	146f	2671	12.9g	38
131	SONY MUSIC ENTERTAINMENT	712	5106	47	-6	1	2.7	46	0.6	1761f	110f	2431	5.7g	44
132	SUMITOMO MARINE & FIRE	716	5096	8	-16	-9	2.4	51	0.8	4813f	99f	22427	4.6g	61
133	NIPPON TELEVISION NETWORK	721	5061	399	41	52	4.1	43	0.3	2312	119	1918	9.5	5
134	ISHIKAWAJIMA-HARIMA HEAVY INDUSTRIES	723	5059	4	-15	-8	3.0	43	1.3	9182f	118f	11451	6.9g	38
135	NIPPON PAPER INDUSTRIES	725	5055	5	-21	-14	1.9	24	1.3	9182	207	10708	7.8	27
136	MITSUI MARINE & FIRE	746	4862	7	-13	-7	2.5	57	0.9	5318	77	22747	4.4g	61
137	NIPPON YUSEN	748	4858	4	-30	-24	2.5	42	0.8	8753f	117f	12042	5.9g	50
138	SHIKOKU ELECTRIC POWER	752	4808	17	-25	-19	1.6	30	2.5	5142	163	12289	5.5	17
139	BANYU PHARMACEUTICAL	754	4780	18	41	52	2.9	46	0.6	1252f*	104f*	2105f*	6.3	41
140	DAIICHI PHARMACEUTICAL	758	4749	17	11	20	1.9	22	0.8	2371f	216f	4193f	8.7	41



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COUNTRY RANK		GLOBAL 1000 RANK	MARKET VALUE U.S. \$ MIL.	PRICE PER SHARE U.S. \$	% CHANGE FROM 1996 (U.S. \$) (LOCAL)	PRICE/BOOK VALUE RATIO	P/E RATIO	YIELD %	SALES U.S. \$ MIL.	PROFITS U.S. \$ MIL.	ASSETS U.S. \$ MIL.	RETURN ON EQUITY %	INDUSTRY CO.	
141	PROMISE	761	4735	48	-5	3	2.7	16	1.0	NA	301f	8165	17.0g	6
142	SHIMIZU	767	4689	6	48	-44	1.5	74	1.3	15673	63	22052	2.1	3
143	DAIEI	772	4655	7	-47	-42	4.5	-46	2.2	27117f	-102f	18848f	NEG	5
144	OBAYASHI	779	4611	6	-33	-27	1.8	45	1.1	10641	103	21187	4.1	3
145	HANKYU CORP.	804	4456	5	-13	6	3.5	-196	0.3	3398	-23	10982	NEG	5
146	PIONEER ELECTRONIC	807	4438	25	11	20	1.8	206	0.2	4742f	22f	4564	0.8g	4
147	YAMATO TRANSPORT	812	4431	12	-1	7	2.5	33	0.9	6094f	134f	4483	7.7g	5
148	FAMILYMART	815	4393	46	10	18	6.2	42	0.5	1261f	105f	1246	14.9g	5
149	MITSUBISHI MATERIALS	816	4389	4	-34	-28	1.7	45	1.1	9678	97	13364	3.8	2
150	TAISEI	820	4367	4	-43	-39	1.3	-261	1.4	16368	-17	27140	NEG	3
151	JOYO BANK	825	4327	5	-35	-30	1.4	84	0.9	NA	52f*	65562*	1.7g	6
152	AISIN SEIKI	828	4315	15	1	8	1.8	38	0.6	7834f	114f	5950f	4.9	3
153	TOYO SEIKAN KAISHA	837	4227	19	-41	-37	1.2	19	0.3	6331	219	6037	6.1	2
154	MYCAL	838	4223	14	-9	-2	2.0	32	1.2	15447f	130f	14496f	6.2	5
155	ONO PHARMACEUTICAL	841	4209	34	-2	6	2.7	20	0.6	1085f*	214f*	2340*	13.6g	4
156	TOTO	846	4178	11	-16	-9	2.0	41	0.8	4053f	102f	4151	4.8g	2
157	EBARA	850	4169	15	-4	3	3.8	49	0.7	4643f	85f	4591	7.6g	3
158	KDD	858	4137	64	-31	-26	1.4	37	0.7	3443f	110f	5492f	3.6	5
159	TEIJIN	862	4106	4	-19	-12	1.5	42	1.2	5485f	97f	7433	3.6g	2
160	ODAKYU ELECTRIC RAILWAY	868	4054	6	-17	-11	3.4	140	0.8	4922	29	9193	2.4	5
161	GUNMA BANK	869	4053	8	-29	-23	2.0	76	0.5	NA	53f*	46139*	2.6g	6
162	CHIBA BANK	873	4039	5	-40	-36	1.2	92	0.8	NA	44f*	67294f*	1.3	6
163	TAKASHIMAYA	883	3979	13	-20	-14	2.6	50	0.5	10641f	80f	7436	5.2g	5
164	SUMITOMO METAL MINING	884	3971	7	-26	-20	2.0	43	0.7	4393	92	5358	4.7	2
165	ISUZU MOTORS	889	3954	4	-29	-24	4.0	48	1.1	16476f	82f	13220	8.2	3
166	YAMAHA	893	3917	19	18	27	2.5	45	0.4	5190f	121f	4410	5.6	4
167	ORIX	897	3897	60	53	65	3.5	59	0.2	NA	66	39995	5.8	6
168	FURUKAWA ELECTRIC	900	3886	6	1	8	2.3	36	0.9	6473f	109f	7483	6.4g	3
169	HOKURIKU ELECTRIC POWER	908	3857	18	-24	-18	1.5	36	2.5	4335	108	12640	4.3	1
170	TOBU RAILWAY	914	3846	4	-31	-26	3.2	-892	1.0	3046	-4	9764	NEG	5
171	HITACHI ZOSEN	919	3827	4	-31	-26	4.3	38	1.4	5451f	101f	5993	11.3g	3
172	MINEBEA	922	3816	10	18	27	3.8	50	0.6	2599f	76f	4778	7.6g	3
173	HOKKAIDO ELECTRIC POWER	924	3800	17	-24	-18	1.7	25	2.5	4715	149	11702	6.6	1
174	YAMAZAKI BAKING	936	3743	17	-14	7	2.1	33	0.6	5699	115	3521e	6.5g	4
175	UNY	940	3720	20	-7	0	2.2	44	0.7	8581f	85f	4835	5.0g	5
176	BANK OF FUKUOKA	941	3715	6	-27	21	1.8	86	0.7	NA	43f*	57196*	2.0g	6
177	NSK	948	3685	7	-14	-7	1.8	49	0.8	4131f	76f	5937	3.8g	3
178	MAZDA MOTOR	952	3661	3	-37	-32	1.2	-24	0.0	16219f	-151f	11741	NEG	4
179	NIPPON CREDIT BANK	955	3649	2	-44	-39	0.9	-1	1.0	NA	-3233f	144146	NEG	6
180	NISSHO IWAI	963	3632	4	-27	-21	1.8	27	1.0	76289f	132f	42930	6.5g	5
181	KINDEN	981	3539	13	-17	-10	1.5	23	0.7	4858f*	155f*	5350f*	6.5	3
182	CREDIT SAISON	998	3454	22	5	14	2.6	32	0.6	NA	108f*	6501f*	7.9	6

NETHERLANDS

COUNTRY COMPOSITE		355944	90	29	44	7.5	26	1.8	308868	22862	1080450	27.6	
1 ROYAL DUTCH PETROLEUM (1)	NR	103681	193	28	43	3.0	21	2.8	134281	9310	119832	14.4	1
2 ING GROEP	70	34767	44	35	51	2.0	19	2.4	NA	1707	252194	10.1	6
3 UNILEVER NV (2)	NR	30820	193	42	59	6.8	24	1.9	50756	2437	31242	28.0	4
4 ABN AMRO HOLDING	109	25411	19	34	51	2.3	16	3.0	NA	1624	310232	14.7	6
5 AEGON	169	19437	73	53	72	3.3	23	2.0	8705	817	95440	14.6	6
6 PHILIPS ELECTRONICS	172	19369	55	55	73	2.7	46	1.5	36063	377	28702	5.8	4
7 KONINKLIJKE PTT NEDERLAND	211	16381	35	-3	9	2.0	13	4.2	10687	1283	18694	15.3	5
8 KONINKLIJKE AHOLD	264	12839	76	42	59	8.1	39	1.2	19043	330	4819e	20.8g	5
9 ELSEVIER (5)	NR	11278	17	9	23	7.1	29	2.3	5531	987	8420	24.5	5
10 AKZO NOBEL	371	9491	133	10	24	2.4	14	2.9	11694	669	10636	16.8	2
11 HEINEKEN	418	8501	169	-25	-16	3.6	25	1.1	6352	342	5553	14.5	4
12 POLYGRAM	419	8499	47	-19	-9	4.9	23	1.1	4945	376	4904	21.8	4
13 WOLTERS KLUWER	438	8174	120	8	21	13.2	32	1.1	2249	252	3516	40.5	5
14 FORTIS AMEV (6)	NR	7518	41	32	48	2.2	17	2.4	NA	906	175360	12.8	6
15 DORDTSCH PETROLEUM	488	7212	200	25	40	16.9	39	2.6	NA	184	428	43.2	1
16 VENDEX INTERNATIONAL	794	4493	56	76	97	7.5	17	1.9	6330f	266f	2896f	44.5	4
17 HAGEMEIJER	805	4454	49	43	61	7.5	30	1.2	4282	149	2382	25.1	5
18 RANDSTAD HOLDING	824	4345	101	39	56	15.6	40	1.0	3103	108	785	38.8	5
19 VNU	830	4284	23	38	55	8.2	26	1.3	1756	165	1359	31.4	5
20 GUCCI GROUP	870	4052	69	3	16	20.9	24	0.4	881f	168f	349	86.7g	4
21 KONINKLIJKE VERENIGDE BEDRIJVEN NUTRICIA	929	3774	156	46	64	19.1	31	1.1	1517	121	946	61.4	4
22 HEINEKEN HOLDING	949	3677	147	-28	-19	3.1	22	1.2	NA	171	1203	14.5	4
23 ASM LITHOGRAPHY HOLDING	995	3488	51	114	140	10.4	31	0.0	694	113	559	33.8	4

NEW ZEALAND

COUNTRY COMPOSITE		12938	4	14	12	3.7	20	4.2	4177	705	8508	21.0	
1	TELECOM CORP. OF NEW ZEALAND	400	8783	5	18	17	6.1	17	5.6	2146f	532f	3168	37.0g
2	CARTER HOLT HARVEY	852	4155	2	10	8	1.2	24	2.9	2032f	173f	5340	5.0g



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THE BUSINESS WEEK GLOBAL 1000

COUNTRY RANK	GLOBAL 1000 RANK	MARKET VALUE U.S. \$ MIL	PRICE PER SHARE U.S. \$	% CHANGE FROM 1996 (U.S. \$) (LOCAL)	PRICE/BOOK VALUE RATIO	P/E RATIO	YIELD %	SALES U.S. \$ MIL	PROFITS U.S. \$ MIL	ASSETS U.S. \$ MIL	RETURN ON EQUITY %	INDUST. CODE	
NORWAY													
COUNTRY COMPOSITE		15633	69	41	53	2.7	15	1.6	15581	1091	17188	17.2	
1	NORSK HYDRO	295	11464	50	6	15	2.2	14	2.0	11926	845	13464	16.5
2	ORKLA	849	4170	87	76	92	3.1	17	1.1	3655	246	3725	18.0
SINGAPORE													
COUNTRY COMPOSITE		104454	9	3	4	2.7	19	1.7	20373	5404	178212	13.1	
1	SINGAPORE TELECOMMUNICATIONS	97	27524	2	-35	-35	6.0	24	1.3	3093f	1160f	7596f	25.5
2	OCBC OVERSEAS CHINESE BANK	268	12526	12	4	6	3.5	25	0.7	NA	495	31808e	13.9g
3	SINGAPORE AIRLINES	315	10946	9	-17	-16	1.5	15	1.4	5052f	722f	10158f	9.8
4	UNITED OVERSEAS BANK	356	9842	10	13	15	3.2	19	0.9	NA	501	28377e	16.9g
5	DEVELOPMENT BANK OF SINGAPORE	405	8655	13	6	7	2.0	18	0.7	NA	468	38991	10.7
6	CITY DEVELOPMENTS	479	7381	9	21	23	4.0	20	0.4	NA	375	5817	20.2
7	HONGKONG LAND HOLDINGS	484	7267	3	22	22	0.7	11	4.5	NA	649	12187	6.4
8	SINGAPORE PRESS HOLDINGS	527	6748	20	6	8	5.1	30	0.8	623	215	1565	16.9
9	JARDINE MATHESON HOLDINGS	728	5018	7	-12	-12	1.2	17	3.7	11605	300	14285	7.3
10	OVERSEAS UNION BANK	771	4662	7	-3	-2	2.3	21	0.9	NA	217	17927e	10.6g
11	JARDINE STRATEGIC HOLDINGS	901	3886	4	24	24	0.8	13	3.9	NA	302	9501	6.1
SPAIN													
COUNTRY COMPOSITE		135274	69	39	56	3.0	22	2.4	53778	6609	545898	14.2	
1	TELEFONICA NACIONAL DE ESPANA	101	27150	29	61	81	2.2	24	2.1	13902	1111	37670	9.0
2	ENDESA	160	19893	77	23	38	3.4	18	2.5	8967	1144	14789e	18.9g
3	BANCO BILBAO VIZCAYA	217	15948	71	88	111	3.0	21	2.3	NA	723	119178	14.2
4	BANCO DE SANTANDER	246	13648	85	88	110	3.4	22	2.6	NA	593	114077e	15.5g
5	REPSOL	267	12578	42	23	38	2.9	16	3.0	19209	825	11563e	18.2g
6	IBERDROLA	307	11202	12	22	36	1.7	17	3.9	5658	670	21369e	10.2g
7	GAS NATURAL SDG	498	7127	191	8	21	5.7	22	0.8	2309	336	4164e	26.4g
8	BANESTO	550	6496	11	68	88	3.8	36	0.0	NA	171	38860	10.4
9	ARGENTARIA, CORP. BANCARIA DE ESPANA	587	6112	50	19	34	1.5	36	3.9	NA	216	76239	4.2
10	BANCO POPULAR ESPANOL	604	6020	213	22	37	2.7	14	3.5	NA	423	24122	19.3
11	BANCO CENTRAL	687	5296	32	61	80	1.8	21	2.4	NA	232	81358	8.6
12	PRYCA	923	3803	20	-14	-4	3.5	23	2.2	3733	166	2508	15.2
SWEDEN													
COUNTRY COMPOSITE		176953	32	38	58	3.7	17	2.4	127527	11817	434783	20.0	
1	L. M. ERICSSON	71	33849	35	57	81	6.9	35	0.9	16080	920	14512	19.5
2	ASTRA	103	26361	16	-6	8	5.7	22	1.2	5045	1223	6758	26.5
3	VOLVO	262	12876	28	32	52	1.8	6	2.0	20194	1614	18266	27.8
4	ABB AB (4)	NR	12682	14	31	50	5.2	23	1.7	34574	1233	30896	22.7
5	INVESTOR	370	9491	50	36	57	4.3	-29	2.6	NA	1227	12050e	NEG
6	SANDVIK	489	7207	26	17	34	3.1	20	3.3	3657	403	4241	15.6
7	FOERENINGSSPARBANKEN	514	6879	20	68	92	2.0	11	3.6	NA	612	80460	17.5
8	HENNES & MAURITZ	526	6773	33	123	156	11.1	39	0.9	1883	172	928	28.3
9	SVENSKA HANDELSBANKEN	556	6443	27	32	52	1.9	10	2.4	NA	659	73902	20.0
10	INCENTIVE	591	6094	89	74	99	3.4	17	1.5	2616	373	4490	19.5
11	NORDBANKEN	640	5675	31	73	99	2.8	8	4.0	NA	696	47565	34.3
12	SCANIA	655	5538	28	-2	13	6.1	27	2.6	4365	256	3712e	23.0g
13	SKANDINAVISKA ENSKILDA BANKEN	671	5455	10	49	71	2.1	9	3.4	NA	608	71250	23.7
14	SKANSKA	717	5084	40	24	42	2.9	10	3.2	5876	499	6628	28.0
15	ATLAS COPCO	741	4912	27	45	66	3.4	21	1.8	3251	251	3008	16.5
16	STORA KOPPARBERGS BERGSLAGS	756	4767	15	11	28	1.3	33	3.3	5844	202	8027	4.0
17	SYDKRAFT	763	4716	26	19	37	2.5	11	2.0	1756	235	5444	23.0
18	ELECTROLUX	818	4378	60	29	48	1.6	22	2.7	13141	213	10350	7.1
19	SVENSKA CELLULOZA AKTIEBOLAGET	853	4151	21	8	24	1.5	16	3.2	7169	274	8798	9.3
20	SKANDIA FORSAKRING	964	3622	35	39	59	3.6	25	1.0	2077	148	23499e	14.5g
SWITZERLAND													
COUNTRY COMPOSITE		403139	1551	25	42	3.5	25	1.2	188891	8113	1306222	13.7	
1	NOVARTIS	11	93477	1361	38	56	5.1	58	1.0	25613	1629	41019	8.8
2	ROCHE HOLDING	14	83514	13148	8	22	8.0	41	0.4	11286	2756	28117	19.4
3	NESTLE	38	48932	1244	10	25	3.3	20	1.7	42760	2404	36077	16.4
4	UBS	92	28128	1097	17	32	1.8	-114	2.1	NA	-247	309088	NEG
5	CREDIT SUISSE GROUP	115	24399	126	46	65	2.3	-13	2.3	NA	-1830	370519	NEG
6	SWISS RE	164	19636	1343	39	57	3.3	19	1.6	9508	1031	32246e	17.4g
7	SWISS BANK CORP.	179	18635	240	35	53	1.9	-13	0.0	NA	-1382	254441	NEG
8	ZURICH INSURANCE GROUP	205	16727	368	39	58	1.8	21	1.4	20285	805	92556	8.6



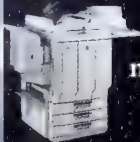
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THE BUSINESS WEEK GLOBAL 1000

COUNTRY RANK		GLOBAL 1000 RANK	MARKET VALUE U.S. \$ MIL	PRICE PER SHARE U.S. \$	% CHANGE FROM 1996 (U.S. \$) (LOCAL)	PRICE/BOOK VALUE RATIO	P/E RATIO	YIELD %	SALES U.S. \$ MIL	PROFITS U.S. \$ MIL	ASSETS U.S. \$ MIL	RETURN ON EQUITY %	INDUST CODE	
9	ABB AG (4)	NR	12518	1373	15	30	4.2	22	2.0	34574	1233	30896	19.3	34
10	COMPAGNIE FINANCIERE RICHEMONT	456	7834	1364	-8	4	2.6	16	1.0	7046	517	7547	16.5	71
11	WINTERTHUR	492	7186	817	39	57	2.1	21	1.8	16530	348	68618	10.1	63
12	CIBA SPECIALTY CHEMICALS	521	6832	95	NA	NA	2.2	-19	0.0	4765	-365	6487	NEG	22
13	HOLDERBANK FINANCIERE GLARUS	576	6226	878	15	29	2.1	206	1.4	NA	30	12133	1.0	21
14	ADECCO	578	6184	376	62	83	3.8	35	0.9	6026	170	3448	10.9	52
15	ALUSUISSE-LONZA HOLDING	632	5734	922	18	33	3.5	19	1.4	5686	295	5438	18.3	71
16	ARES-SERONO	715	5098	1361	76	99	8.0	83	0.3	805	53	1328e	9.6g	45
17	S. M. H.	833	4261	590	-14	-2	2.4	20	1.1	1919	199	2369e	12.3g	46
18	PHARMA VISION 2000	864	4086	548	20	36	2.8	NA	0.0	NA	280*	1879*	NA	62
19	SGS STE GENERALE DE SURVEILLANCE HOLDING	939	3730	2216	-2	11	4.7	21	2.1	2088	186	2015	23.0	52

UNITED STATES

COUNTRY COMPOSITE			6605427	152	28	28	4.7	21	1.7	3821467	313558	10659721	21.5	
1	GENERAL ELECTRIC	1	198088	60	46	46	6.4	27	1.7	79179	7280	272402	23.8	71
2	COCA-COLA	2	169857	69	49	49	27.6	45	0.8	18546	3492	16161	61.3	43
3	MICROSOFT	5	148593	124	109	109	21.4	55	0.0	8671	2195	10093	39.2	52
4	EXXON	6	147151	59	40	40	3.4	19	2.8	116728	7510	95527	17.8	11
5	INTEL	7	124079	152	101	101	7.4	22	0.2	20847	5157	23735	34.0	35
6	MERCK	9	108489	90	39	39	9.1	27	1.9	19829	3881	24293	33.7	45
7	PHILIP MORRIS	10	106580	44	33	33	7.5	17	3.6	54553	6303	54871	45.5	43
8	PROCTER & GAMBLE	12	93392	138	57	57	9.6	29	1.3	35284	3046	27730	33.2	44
9	INTERNATIONAL BUSINESS MACHINES	13	85908	87	62	62	4.1	15	0.9	75947	5864	81132	26.6	33
10	JOHNSON & JOHNSON	17	79914	60	23	23	7.4	27	1.5	21620	2887	20010	27.8	45
11	BRISTOL-MYERS SQUIBB	18	73375	73	72	72	11.2	25	2.1	15065	2850	14685	44.6	45
12	WAL-MART STORES	20	67683	30	15	15	4.0	22	0.9	104859f	3056f	39604f	18.3	54
13	PFIZER	22	64375	103	46	46	9.3	33	1.3	11306	1929	14667	28.0	45
14	AMERICAN INTERNATIONAL GROUP (8)	23	63567	135	44	44	2.8	21	0.3	28106	2897	148431	13.4	63
15	DUPONT	24	61449	109	36	36	5.9	16	2.3	38349	3636	37987	36.6	22
16	AT&T	26	59710	37	-15	-15	2.9	11	3.6	52184	5608	55552	25.9	55
17	PEPSICO	27	56314	37	11	11	8.6	31	1.4	31645	1865	24512	28.0	43
18	WALT DISNEY	28	55277	82	35	35	3.4	28	0.7	21238	1533	37306	12.4	53
19	MOBIL	29	55026	140	24	24	3.0	18	3.0	71129	2964	46408	16.3	11
20	SBC COMMUNICATIONS	31	53642	59	18	18	3.7	17	3.1	23486	3158	39599	21.3	55
21	BERKSHIRE HATHAWAY (8)	32	52976	43000	41	41	2.2	47	0.0	10500	2489	43410	4.6	71
22	CITICORP	34	52558	114	36	36	2.8	15	1.8	NA	3788	281018	19.3	61
23	HEWLETT-PACKARD	35	52530	52	-3	-3	3.9	20	1.1	38420	2586	27699	19.9	33
24	ELI LILLY	36	51651	93	45	45	8.4	32	1.6	7347	1524	14307	26.3	45
25	GILLETTE	37	49517	89	50	50	11.2	39	1.0	9698	1232	10435	28.8	45
26	AMERICAN HOME PRODUCTS	39	48924	76	42	42	7.0	25	2.2	14088	1875	20785	28.2	45
27	ABBOTT LABORATORIES	40	48731	63	46	46	10.1	25	1.7	11013	1882	11126	40.0	45
28	FANNIE MAE	43	46419	44	42	42	3.9	17	1.9	NA	2754	351041	23.1	62
29	CHEVRON	44	45735	70	17	17	2.9	16	3.3	37580	2651	34854	18.2	11
30	BELLSOUTH	46	44976	45	12	12	3.4	15	3.2	19040	2863	32568	22.1	55
31	CISCO SYSTEMS	47	44962	68	24	24	15.6	35	0.0	4096	913	3630	44.0	35
32	FORD MOTOR	48	44656	38	3	3	1.7	9	4.5	146991	4446	262867	19.5	42
33	AMOCO	49	44166	89	23	23	2.7	16	3.1	32150	2834	32100	17.1	11
34	NATIONSBANK	51	42341	59	45	45	2.5	14	2.2	NA	2452	185794	18.0	61
35	GTE	52	42137	44	3	3	5.8	15	4.3	21339	2798	38422	38.7	55
36	GENERAL MOTORS	53	41833	57	4	4	1.9	8	3.5	164069	5891	222142	24.1	42
37	BANKAMERICA	54	41443	117	55	55	2.3	15	2.1	NA	2873	250753	14.6	61
38	CHASE MANHATTAN	55	40740	95	35	35	2.3	12	2.6	NA	3586	333823	18.4	61
39	LUCENT TECHNOLOGIES	56	40635	64	67	67	15.1	16	0.5	15859a	202a	22626	92.9	34
40	MOTOROLA	60	39418	66	-1	-1	3.3	37	0.7	27973	1154	24076	9.1	35
41	MINNESOTA MINING & MFG.	61	38242	92	40	40	6.1	25	2.3	14236	1516	13364	24.9	71
42	BOEING	63	37992	105	24	24	3.4	27	1.1	25214	1123	27254	12.5	31
43	AMERITECH	66	35964	66	16	16	4.7	16	3.5	14917	2134	23707	28.5	55
44	TRAVELERS GROUP	68	35270	55	77	77	2.8	15	1.1	NA	2227	151067	18.4	62
45	MCDONALD'S	69	34769	50	4	4	4.2	22	0.7	10687	1573	17386	18.8	53
46	SCHERING-PLOUGH	72	33201	91	55	55	16.1	26	1.7	5656	1213	5398	61.0	45
47	AMERICAN EXPRESS	73	32859	70	52	52	3.9	19	1.3	NA	1739	108512	20.6	62
48	ALLSTATE	75	32260	74	74	74	2.4	14	1.3	18366	2075	74508	17.8	63
49	BELL ATLANTIC	78	30660	70	12	12	4.1	17	4.2	13081	1739	24856	24.0	55
50	HOME DEPOT	79	30657	63	23	23	5.1	31	0.5	19536f	938f	9342f	16.6	54
51	ORACLE	81	30465	47	41	41	16.4	43	0.0	4223	603	3357	37.9	52
52	COMPAQ COMPUTER	83	29680	108	122	122	4.8	21	0.0	18109	1313	10526	23.3	33
53	SCHLUMBERGER	84	29393	119	43	43	5.2	31	1.3	8956	851	10325	16.8	36
54	TEXACO	87	28769	109	30	30	3.0	17	3.1	45500	1665	26963	17.8	11
55	KIMBERLY-CLARK	93	28123	50	38	38	6.3	21	1.9	13149	1331	11846	30.7	45
56	WARNER-LAMBERT	98	27408	101	80	80	10.6	35	1.5	7231	787	7197	30.2	45

Many farmers today are receiving messages from outer space.

[High-tech farming],

including satellite signals
carrying valuable crop
information, is much more
than an advantage for
farmers. If we're going to
make sure there's enough
food for a growing world,

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Feeding the world
is the biggest challenge
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THE BUSINESS WEEK GLOBAL 1000

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57	EASTMAN KODAK	100	27268	83	11	11	5.8	31	2.1	15968	1011	14438	18.6	46
58	WORLDCOM	102	26450	30	21	21	2.0	-12	0.0	4485	-2189	19862	NEG	55
59	MCI COMMUNICATIONS	104	26238	38	32	32	2.5	22	0.1	18494	1202	22978	11.1	55
60	TIME WARNER	105	26032	47	15	15	2.7	-68	0.8	10064	-156	35064	NEG	51
61	MONSANTO	106	26030	44	45	45	7.0	28	1.5	9262	885	11191	25.4	22
62	COLUMBIA/HCA HEALTHCARE	114	24492	36	1	1	2.8	16	0.2	19909	1505	21272	18.0	52
63	EMERSON ELECTRIC	117	24162	54	26	26	4.5	23	2.0	11150	1019	10481	20.0	34
64	FIRST UNION	118	24048	86	40	40	2.5	13	2.7	NA	1766	140127	18.6	61
65	NYNEX	121	23610	54	16	16	3.3	15	4.4	13454	1346	27659	22.4	56
66	WELLS FARGO	122	23562	264	9	9	1.8	25	2.0	NA	1071	108888	7.1	61
67	ATLANTIC RICHFIELD	125	23439	146	22	22	3.0	13	3.9	18592	1663	25715	22.8	17
68	FEDERAL HOME LOAN MORTGAGE	128	22935	33	60	60	3.4	19	1.2	NA	1258	173866	17.8	62
69	HUGHES ELECTRONICS (8)	138	22044	55	-9	-9	2.4	21	1.8	15744	1151	16480	11.6	31
70	CHRYSLER	142	21928	32	-4	-4	1.9	6	5.0	61397	3720	56184	31.4	42
71	XEROX	143	21927	68	29	29	5.0	19	1.9	17378	1206	26818	26.6	33
72	ALLIEDSIGNAL	146	21721	77	40	40	5.2	21	1.4	13971	1020	12829	25.3	71
73	CAMPBELL SOUP	148	21495	46	43	43	8.3	26	1.7	7678	802	5632	32.1	44
74	ANHEUSER-BUSCH	150	21272	43	20	20	5.3	19	2.2	10884	1156	10464	28.6	43
75	SPRINT	152	21044	49	15	15	2.5	18	2.1	14045	1191	16953	13.5	58
76	NORWEST	158	20078	54	53	53	3.4	17	2.2	NA	1154	80175	19.9	61
77	COMPUTER ASSOCIATES INTERNATIONAL	161	19881	55	13	13	13.4	22	0.2	4040f	964f	5016	62.3g	52
78	SARA LEE	165	19633	41	22	22	4.6	21	2.1	18624	916	12602	22.2	44
79	DOW CHEMICAL	168	19524	83	0	0	2.5	11	4.2	20053	1900	24673	23.4	22
80	J. P. MORGAN	170	19375	108	24	24	1.9	14	3.3	NA	1574	222026	13.0	61
81	SEARS, ROEBUCK	174	19234	49	-3	-3	3.9	15	1.9	38236	1271	36167	25.5	54
82	UNITED TECHNOLOGIES	175	19040	80	47	47	4.4	22	1.5	23273	906	16745	20.4	33
83	DELL COMPUTER	177	18841	113	306	306	24.2	33	0.0	7759f	531f	2993f	73.6	33
84	CATERPILLAR	181	18583	98	49	49	4.5	13	1.6	16522	1361	18728	35.2	38
85	ELECTRONIC DATA SYSTEMS	184	18298	37	-34	-34	3.8	19	1.6	14441	1328	11193	20.6	52
86	COLGATE-PALMOLIVE	185	18284	62	57	57	11.1	28	1.8	8749	635	7902	39.1	41
87	FIRST CHICAGO NBD	186	18283	59	36	36	2.2	13	2.7	NA	1436	104619	16.6	61
88	BANC ONE	188	18153	43	17	17	2.2	13	3.5	NA	1427	101848	16.8	61
89	LOCKHEED MARTIN	191	18082	94	12	12	3.1	15	1.7	26875	1205	29257	20.4	33
90	FIRST DATA	193	17940	40	0	0	4.8	29	0.2	NA	628	14340	16.8	51
91	AMGEN	195	17713	67	12	12	9.3	26	0.0	2240	680	2766	35.6	41
92	MEDTRONIC	196	17629	74	32	32	9.7	33	0.5	2438f	530f	2503	29.1g	41
93	US WEST COMMUNICATIONS GROUP	197	17595	37	12	12	4.5	14	5.9	10079	1215	16915	32.0	51
94	PHARMACIA & UPJOHN	198	17574	35	-15	15	3.0	35	3.1	7176	562	11173	8.5	41
95	MERRILL LYNCH	200	17508	106	64	64	2.8	12	1.5	NA	1619	213016	22.3	61
96	TEXAS INSTRUMENTS	201	17154	90	60	60	4.2	-408	0.8	9940	-46	9360	NEG	33
97	UNION PACIFIC	204	16728	68	41	41	2.0	19	2.5	8786	733	27914	10.8	51
98	NIKE	208	16602	58	15	15	6.8	22	0.7	6471	553	3952	31.1	41
99	BANK OF NEW YORK	209	16422	43	64	64	3.3	17	2.3	NA	1020	55765	19.5	61
100	ASSOCIATES FIRST CAPITAL (8)	212	16379	47	28	28	3.0	18	0.8	7098	857	48268	16.6	61
101	H. J. HEINZ	218	15809	43	29	29	5.9	23	2.7	9112	659	8624	25.5	41
102	FLEET FINANCIAL GROUP	221	15637	61	39	39	2.5	15	2.9	NA	1139	85518	16.7	61
103	TRAVELERS PROPERTY CASUALTY (8)	223	15404	39	41	41	2.4	28	0.8	8197	391	49779	8.4	61
104	KELLOGG	224	15324	74	1	1	12.1	26	2.3	6677	651	5050	46.6	41
105	AETNA	227	15133	101	37	37	1.5	24	0.8	9289	576	92913	6.3	51
106	BAXTER INTERNATIONAL	233	14624	53	28	28	5.7	25	2.1	5438	575	7596	23.4	41
107	WASTE MANAGEMENT	235	14527	32	-9	-9	3.2	33	2.1	9187	478	18367	9.6	51
108	INTERNATIONAL PAPER	237	14403	48	20	20	1.5	42	2.1	20143	434	28252	3.7	21
109	SOUTHERN	238	14400	21	-9	-9	1.6	13	6.2	10324	1127	30292	11.8	11
110	AUTOMATIC DATA PROCESSING	239	14385	49	28	28	6.1	28	0.9	3567	455	3840	21.6	51
111	GENERAL RE	241	14147	175	20	20	2.0	15	1.3	6678	894	40161	12.6	61
112	ROCKWELL INTERNATIONAL	242	14090	65	18	18	2.6	23	1.8	10373	555	10065	11.2	31
113	AIRTOUCH COMMUNICATIONS	243	14024	28	-13	-13	3.5	65	0.0	2252	199	8524	5.4	51
114	CONAGRA	247	13632	60	42	42	6.1	23	1.8	24822	545	11197	26.0	41
115	MCDONNELL DOUGLAS	250	13516	64	27	27	4.4	18	0.8	13834	788	11631	24.9	31
116	MORGAN STANLEY, DEAN WITTER, DISCOVER	255	13346	42	40	40	2.4	28	1.4	NA	951	42414	8.7	61
117	PNC BANK	258	13143	42	38	38	2.3	14	3.5	NA	992	73260	16.7	61
118	GANNETT	259	13093	93	33	33	4.5	22	1.6	4419	547	6350	20.3	51
119	DEERE	260	13051	51	23	23	3.7	15	1.6	9640	817	14653	24.7	31
120	J. C. PENNEY	261	13047	52	-1	-1	2.1	23	4.2	22653f	565f	22088f	9.1g	51
121	CIGNA	263	12856	174	51	51	1.8	12	1.9	13916	1056	98932	15.0	61
122	BURLINGTON NORTHERN SANTA FE	265	12805	83	-2	-2	2.1	15	1.5	8187	889	19846	14.0	51
123	ALUMINUM CO. OF AMERICA	266	12701	74	19	19	2.9	26	1.4	13061	515	13450	11.2	21
124	ILLINOIS TOOL WORKS	270	12398	50	49	49	5.1	24	0.8	4997	486	4806	21.3	31

"Everybody seems to be talking about total cost of ownership. In the last week, I've read ten different ways to measure it, six different names to call it, three different approaches to begin thinking about it, and two different strategies to cope with it. To be frank, I just want to solve it."

what works?

Speaking Productively: A Partnership Approach to TCO

This is a story about productivity. It's also a story about partnership. But it isn't a story about the horrors of TCO. You don't need another article to tell you what you already know: that PCs cost too much to manage, to run, to upgrade. **What you need are answers.**

So within this article, we're going to give you some answers. We're going to paint a picture of what your computing environment could look like in less than a year, and how, working hand-in-hand with our partners, we're going to deliver it.

Listening to our most important partner. You. At Microsoft, when we set out to study TCO issues, we went straight to the source: CIOs. IT managers. System administrators. People like you who live and breathe cost of ownership issues every day. And who have a very clear idea of what the future could be if someone would just stop for a moment, and listen.

So we did. We listened. Then we joined with PC and key component manufacturers who also were busy listening. And using what we heard, we forged partnerships with them founded on a common belief: that it is not enough to lower costs here and there; what works is to increase productivity *everywhere*. Only then can we all realize dramatic savings. Only then can we focus on what's truly important: total business value.

A word about these partnerships. These aren't simple ink-and-handshake deals; this is old-fashioned teamwork. We don't just pick up the phone and chat. We live in each others' offices. We hammer out specs. We share customer input. In short, we put our collective heads together. And you know where it's taken us? To a long-term solution that doesn't just address the cost of ownership problem. It tackles it head-on. And at the same time, ushers in a new era of computing that will help people accomplish more. With less. Here's how.

“What does helping people
and faster have to
do with
Everything.”

Standards are empowerment. Our strategy is founded on standards. Standards are glue. Standards extend the value of a distributed environment by ensuring that all the pieces fit together seamlessly. They aren't one company's idea of what comes next. Standards are simply this: roadmaps. And they belong to us all.

The fact that the Microsoft® Windows® PC environment is based on standards is no accident. And the result—that it has empowered millions of people to get more work done in less time—is no coincidence.

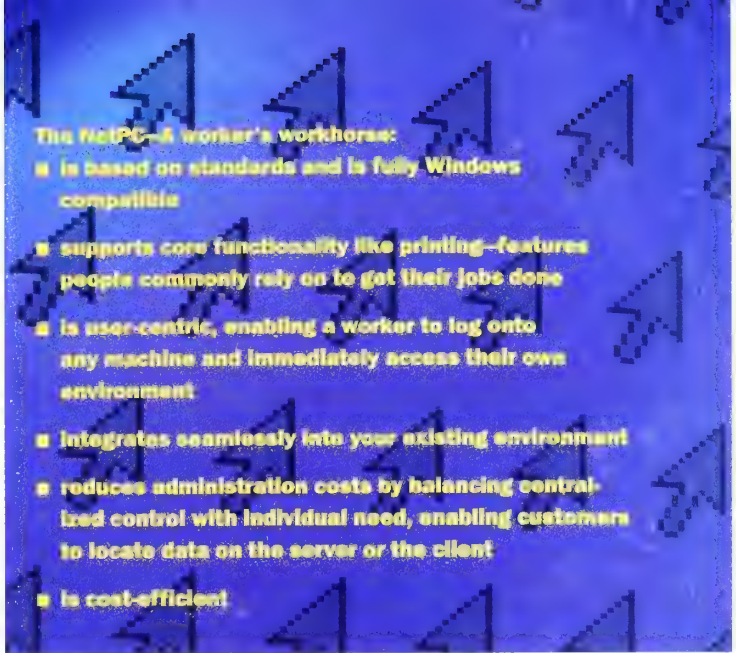
As the Windows PC environment continues to evolve, its ability to empower won't change. It will grow. From the handheld Windows CE, to the portable computer, the desktop PC, the Windows NT® Workstation, to the newest kid on the block—the NetPC—the Windows PC platform will enable people to be even more productive no matter where they are. Because while all these pieces work separately, they also work in one other important way. Together.

What's an interesting point to bear in mind as you consider your next technology move. Because while others may prefer technology they claim also works, the question is, what will it work with?

Enabling, not disabling technology. With our partners, Microsoft will soon be delivering two key productivity solutions based on standards: The Zero Administration Initiative for Windows (ZAW) and the Network PC. Take a closer look at the NetPC.

Designed as a complement to, rather than a replacement for, your organization's existing environment, the NetPC is an example of how, with our partners, Microsoft has eliminated extra costs by tightening the standards for the corporate PC—without jeopardizing the kind of flexibility and compatibility organizations need to be productive. At the core of these tightened standards is the right balance of centralized control.

"Right balance" is the key phrase there. It offers the kind of control that allows your network administrators to remotely configure, upgrade, and manage systems (which means, among other things, that individuals will no longer be able to install "junkware" on their work systems). But it also



The NetPC—A worker's workhorse:

- is based on standards and is fully Windows compatible
- supports core functionality like printing—features people commonly rely on to get their jobs done
- is user-centric, enabling a worker to log onto any machine and immediately access their own environment
- integrates seamlessly into your existing environment
- reduces administration costs by balancing centralized control with individual need, enabling customers to locate data on the server or the client
- is cost-efficient

Choice is the power to select from any of more than 100,000 Windows-compatible applications (including your own custom programs) to run your business. But choice goes beyond what's here now; it's also about what comes next. Because choice enables the freedom to move forward to new technologies as you see fit, backed by the power of compatibility, interoperability, and integration.

Work smarter, better, with lowering TCO?

includes a hard disk—which ensures that, even if the servers get busy or the network goes down, productive work doesn't go down with it.

Loving it all forward. But what about your existing desktops? That's where Zero Administration Initiative for Windows comes in. ZAW is a long-term plan that will bring you a far easier and better way to deploy and manage your organization's desktops. How much easier? Picture this: in the future, upgrading 250,000 desktops will require three exacting steps: Point. Click. Go to lunch. It'll also be that easy to update the operating system—or perform almost any of the countless tasks that take your time, but not your talent.

ZAW also enables the development and deployment of the widest range of applications and supports the last important concept we want to highlight today: Choice.

An evolutionary beginning. Add it all up—Windows PC, the NetPC, ZAW—and you're left with the three basic tenets of our partnership approach to productivity. Empowerment. Simplicity. Choice. Together they comprise an evolutionary strategy that puts the TCO issue where it belongs: in the soon-to-be extinct category. And ends this story with something you don't often find: a new beginning.

By the way, if this strategy sounds like a productive way to solve your TCO issues, then take a moment and pat yourself on the back. The ideas came from you. All we and our partners did was take the time to listen. And make the commitment to act.

Compaq: Sensible Scalability. At Compaq, we're not only committed to helping corporations find new ways to lower costs—we're providing a full spectrum of scalable solutions that make them reality. Today Compaq offers the full line of Windows PC platforms. From the hand-held Windows CE, to the NetPC, to the laptop, on up. We do so because we know our customers share a common need for continuity. The kind that ensures all the different parts will work just as well together as they do alone.

As we worked with Microsoft on the NetPC specification, it soon became clear to us that here was the missing piece: A computer designed for a new class of end user; someone who needs the performance and compatibility offered by PC architecture, but not the expandability of the mainstream PC. Add in ZAW, with its easy deployment and management capabilities, and it's easy to see where this technology will take our customers. Straight to the bottom line. And well in the black.

from our partners

Dell: Open Standards Flexibility. At Dell, we have a thorough understanding of the cost of ownership issue. Because we speak directly to more than 50,000 of our customers every day. Know what we've heard? That it isn't enough to make a low-cost PC.

We couldn't agree more. That's why we're proud to say we're one of the co-authors with Microsoft on the NetPC specification. This specification addresses the real issues surrounding cost of ownership. And it offers a real solution based on three important customer-driven concerns: applications and performance compatibility, support for existing investments, and adherence to open standards. That last one—adherence to open standards—is especially critical. They are open standards that encourage new technologies to emerge within the frameworks of existing environments and allow customers more product choices.

We're ready for this smarter way to work with our OptiPlex products. Fully NetPC configurable, they offer the price and flexibility our customers have asked for. How do we know? Because our customers tell us. 50,000 times a day.



For further information on
Microsoft's partnership approach
to TCO, the NetPC, and ZAW,
visit our Web site:
www.microsoft.com/windows/newtech/

Hewlett-Packard: Better Productivity. At HP, we believe the PC can be a tool for change. Dramatic change. Not only in the way people interact with it, but in the way the PC can lower costs throughout an organization. That's why we joined Microsoft in the development of the NetPC specification. And from that specification, why we built the HP Net Vectra PC Series.

For end users, the HP Net Vectra PC will deliver the same functionality as a traditional PC—for example, it will run Microsoft Windows and more than 100,000 applications. But from a company-wide perspective, the HP Net Vectra PC will not only cost less, it will lower costs in

new ways, through centralized management capabilities. And it will include additional, complementary management features like HP TopTOOLS.

At HP, our goal is to provide the right technology at the right time. From VAR-configured solutions like Windows NT Servers running the BackOffice™ family to the HP Net Vectra PC, we're continuing to do what we've done all along: improve customer productivity. And profitability.

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THE BUSINESS WEEK GLOBAL 1000

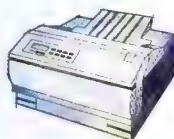
COUNTRY RANK		GLOBAL 1000 RANK	MARKET VALUE U.S. \$ MIL.	PRICE PER SHARE U.S. \$	% CHANGE FROM 1996 (U.S. \$) (LOCAL)	PRICE/ BOOK VALUE RATIO	P/E RATIO	YIELD %	SALES U.S. \$ MIL.	PROFITS U.S. \$ MIL.	ASSETS U.S. \$ MIL.	RETURN ON EQUITY %	INDUSTRY CODE	
25	WESTINGHOUSE ELECTRIC	271	12360	20	10	10	2.1	-506	1.0	8449	-24	19889	NEG	51
26	CPC INTERNATIONAL	272	12346	86	24	24	6.5	22	1.9	9844	580	7875	30.3	44
27	NORFOLK SOUTHERN	275	12185	97	13	13	2.4	16	2.5	4770	770	11416	15.6	57
28	US WEST MEDIA	280	12052	20	5	5	1.6	-55	0.0	2955	-71	24061	NEG	55
29	KEYCORP	283	11904	54	40	40	2.5	14	3.1	NA	860	67621	17.4	61
30	SUN MICROSYSTEMS	284	11896	32	3	3	5.3	19	0.0	7095	476	3801	27.4	33
31	APPLIED MATERIALS	285	11816	65	75	75	5.0	32	0.0	4145	600	3638	15.5	35
32	SUNTRUST BANKS	287	11707	53	46	46	3.6	19	1.7	NA	617	52468	19.1	61
33	MARSH & MCLENNAN	290	11555	132	41	41	5.1	20	3.0	NA	459	4545	25.8	63
34	CORNING	291	11548	50	57	57	12.0	31	1.4	3652	343	4321	38.8	35
35	WALGREEN	292	11507	47	47	47	5.6	29	1.0	11778	372	3634	19.5	54
36	CSX	293	11496	53	7	7	2.3	13	2.0	10536	855	16965	17.4	57
37	CORESTATES FINANCIAL	298	11348	53	34	34	3.0	17	3.6	NA	649	45494	17.8	61
38	MBMA	300	11318	34	66	66	6.6	24	1.4	NA	475	17035	27.6	62
39	NATIONAL CITY	301	11290	52	45	45	2.6	15	3.2	NA	737	50856	16.9	61
40	CARNIVAL	302	11288	38	27	27	3.7	19	1.2	2213	566	5102	19.2	53
41	RAYTHEON	303	11283	48	-10	-10	2.5	15	1.7	12331	761	11126	16.5	31
42	MELLON BANK	304	11273	88	53	53	3.3	16	3.0	NA	733	42596	19.8	61
43	PHILLIPS PETROLEUM	306	11204	43	2	2	2.6	8	3.2	15731	1303	13548	31.1	11
44	LOEWS	308	11188	97	22	22	1.3	8	1.0	19964	1384	67683	16.0	71
45	MAY DEPARTMENT STORES	310	11058	47	-1	-1	2.6	17	2.6	11650f	749f	10059f	15.4g	54
46	FIRST BANK SYSTEM	316	10946	82	36	36	3.6	16	2.3	NA	738	36489	23.4	61
47	ARCHER DANIELS MIDLAND	318	10866	20	8	8	1.8	27	1.0	13314	696	10450	6.6	44
48	MORGAN STANLEY GROUP	320	10725	68	37	37	2.0	10	1.2	NA	1029	196446	18.7	62
49	BANKBOSTON	321	10721	73	46	46	2.5	18	2.8	NA	650	62306	14.3	61
50	RHONE-POULENC RORER	322	10714	76	17	17	5.2	25	1.7	5421	429	8768	20.9	45
51	TYCO INTERNATIONAL	324	10691	64	61	61	4.2	26	0.3	5090	310	3954	16.0	71
52	UNOCAL	326	10640	43	31	31	4.7	21	1.9	5328	456	9123	22.5	11
53	CHUBB	327	10550	61	31	31	2.0	20	1.9	4569	486	23930	9.8	63
54	UNITED HEALTHCARE	328	10523	57	3	3	2.7	30	0.1	10074	393	6997	9.1	52
55	NABISCO HOLDINGS (8)	330	10503	40	17	17	2.6	396	1.6	8889	17	12290	0.7	44
56	PPG INDUSTRIES	331	10478	58	12	12	4.3	15	2.3	7218	744	6441	29.3	22
57	DAYTON HUDSON	333	10470	48	42	42	3.0	20	1.3	25371f	474f	13389f	15.1	54
58	VIACOM	334	10467	30	-30	-30	0.9	165	0.0	12084	171	28834	0.6	51
59	SAFEWAY	335	10449	45	NA	NA	8.4	22	0.0	17269	461	5545	38.1	54
60	ENRON	336	10430	41	2	2	2.9	17	2.2	13289	584	16137	16.6	12
61	BOSTON SCIENTIFIC	338	10379	53	24	24	10.4	23	0.0	1462	281	1512	45.4	45
62	TELE-COMMUNICATIONS	339	10328	15	12	-12	5.4	-14	0.0	6790	-778	27154	NEG	51
63	PITNEY BOWES	343	10239	70	42	42	4.7	22	2.3	3859	469	8156	21.4	33
64	GENERAL MILLS	347	10195	63	10	10	32.7	21	3.4	5416	476	3295	158.7	44
65	BARNETT BANKS	348	10047	53	68	68	3.0	18	2.4	NA	564	41231	16.4	61
66	SEAGATE TECHNOLOGY	350	9963	41	38	38	3.5	14	0.0	8588	213	5240	26.1	35
67	WEYERHAEUSER	354	9887	50	10	10	2.2	27	3.2	11114	463	13596	8.0	23
68	WACHOVIA	357	9835	61	42	42	2.7	15	2.6	NA	645	46905	17.1	61
69	EMC	358	9815	40	81	81	5.8	24	0.0	2274	386	2294	24.2	35
70	EDISON INTERNATIONAL	359	9811	23	42	42	1.6	15	4.3	8544	717	24559	10.7	12
71	HALLIBURTON	360	9786	77	39	39	4.5	24	1.3	7385	386	4437	18.8	36
72	TEXTRON	361	9777	119	40	40	3.1	20	1.7	7179	482	18235	15.2	71
73	HOUSEHOLD INTERNATIONAL	366	9568	98	42	42	3.2	18	1.6	NA	539	29595	18.2	62
74	CONRAIL (8)	367	9564	115	63	63	3.0	25	1.7	3714	342	8402	12.3	57
75	PG&E	374	9455	23	-1	-1	1.1	15	5.2	9610	755	26130	7.5	12
76	GAP	378	9408	34	2	2	5.7	21	0.9	5284f	453f	2627f	27.0	54
77	CUC INTERNATIONAL	379	9395	23	-7	-7	8.9	51	0.0	2348f	164f	2113	17.4	52
78	HONEYWELL	381	9248	73	43	43	4.2	22	1.5	7312	403	5493	18.8	34
79	HARTFORD FINANCIAL SERVICES GROUP	383	9201	78	51	51	2.0	15	2.1	10076	594	108840	13.8	63
80	GOODYEAR TIRE & RUBBER	385	9105	58	16	16	2.8	13	1.9	13113	674	9672	21.2	37
81	DUKE POWER	386	9097	45	-6	-6	1.9	14	4.7	4397	730	13470	13.6	12
82	U. S. BANCORP (8)	387	9094	61	72	72	3.5	19	2.0	2896	479	33260	17.8	61
83	TELLABS	388	9078	50	NA	NA	15.3	68	0.0	869	118	744	22.5	34
84	RALSTON PURINA GROUP	389	9070	85	39	39	12.6	23	1.4	6114	362	4785	54.4	44
85	AMR	390	9063	99	5	5	1.6	11	0.0	17753	854	20497	15.0	56
86	AMERICAN GENERAL	393	9022	44	25	25	1.6	16	3.2	1968	577	66254	10.3	63
87	AMP	395	9005	41	-3	-3	3.2	23	2.5	5468	415	4686	14.3	35
88	TOYS 'R' US	398	8894	31	7	7	2.1	18	0.0	9932f	465f	8023f	11.7	54
89	MICRON TECHNOLOGY	399	8880	42	32	32	3.5	37	0.0	3654	594	3752	9.4	35
90	RJR NABISCO HOLDINGS	402	8758	32	-2	-2	0.9	18	6.3	17063	611	31289	5.0	43
91	3COM	407	8610	49	-2	-2	8.4	21	0.0	2327	280	1525	39.3	33
92	MATTEL	408	8605	30	10	10	5.6	21	0.9	3786	401	2894	26.0	46

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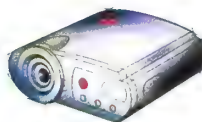
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COUNTRY RANK		GLOBAL 1000 RANK	MARKET VALUE U.S. \$ MIL	PRICE PER SHARE U.S. \$	% CHANGE FROM 1996 (U.S. \$) (LOCAL)	PRICE/ BOOK VALUE RATIO	P/E RATIO	YIELD %	SALES U.S. \$ MIL	PROFITS U.S. \$ MIL	ASSETS U.S. \$ MIL	RETURN ON EQUITY %	INDUS COC	
193	USX-MARATHON GROUP	410	8596	30	37	37	2.6	12	2.5	16332	671	10151	22.0	1
194	HERSHEY FOODS	412	8574	56	54	54	7.4	32	1.4	4474	256	3185	22.8	4
195	AIR PRODUCTS & CHEMICALS	414	8528	78	31	31	3.6	22	1.5	4008	375	6522	16.8	2
196	HFS	416	8518	54	-14	-14	3.0	28	0.0	2004	309	10753f	10.6	5
197	REPUBLIC INDUSTRIES	420	8462	24	NA	NA	3.6	-201	0.0	2366	-28	3776	NEG	5
198	FPL GROUP	421	8461	46	8	8	1.9	14	4.1	6038	579	12219	13.4	1
199	FORTUNE BRANDS	422	8424	49	12	12	2.3	15	4.1	11579	556	9504	15.3	4
200	AVON PRODUCTS	423	8421	64	38	38	35.0	26	2.0	4814	318	2222	132.4	4
201	ALBERTSON'S	424	8398	34	-16	-16	3.7	17	1.9	13777f	494f	4715f	21.8	5
202	SERVICE CORP. INTERNATIONAL	430	8308	35	26	26	3.7	33	0.9	2294	265	8870	11.3	5
203	PRAXAIR	431	8299	53	30	30	4.3	23	0.8	4449	335	7538	18.5	2
204	TENET HEALTHCARE	433	8291	28	28	28	2.3	13	0.0	5559	398	8332	16.8	5
205	FRANKLIN RESOURCES (8)	440	8164	65	64	64	5.3	22	0.5	1555	315	2374	23.5	6
206	AON	444	8113	49	45	45	2.9	27	2.1	3446	351	13723	10.8	6
207	GEORGIA-PACIFIC	445	8074	88	22	22	2.3	50	2.3	13024	223	12818	4.5	2
208	COCA-COLA ENTERPRISES	452	7973	21	100	100	5.6	117	0.2	7921	114	11234	4.8	4
209	FIFTH THIRD BANCORP (8)	453	7945	77	42	42	4.2	23	1.5	1749	335	20549	17.9	6
210	HEALTHSOUTH	458	7761	23	NA	NA	4.8	31	0.0	2437	221	3372	15.4	5
211	FEDERATED DEPARTMENT STORES	461	7710	37	7	7	1.8	23	0.0	15229f	266f	14295	7.5g	5
212	TEXAS UTILITIES	462	7693	34	-16	-16	1.3	10	6.1	6551	754	21376	12.3	1
213	TENNECO	463	7678	45	-3	-3	2.9	32	2.7	6572	218	7587	8.9	7
214	OCCIDENTAL PETROLEUM	465	7667	23	-10	-10	2.0	13	4.3	10557	698	17634	15.5	1
215	AMERICAN ELECTRIC POWER	466	7666	41	1	1	1.7	13	5.9	5849	587	15886	12.8	1
216	CROWN CORK & SEAL	475	7485	58	25	25	2.5	24	1.7	8332	316	12590	10.4	2
217	U. S. ROBOTICS (8)	477	7471	84	-8	-8	9.8	34	0.0	1978	170	1067	28.7	5
218	CONSECO (8)	480	7330	40	120	120	2.3	20	0.3	3067	279	25613	11.9	6
219	UNION PACIFIC RESOURCES GROUP	481	7328	29	12	12	4.8	19	0.7	1831	321	3649	24.9	1
220	MARRIOTT INTERNATIONAL	487	7251	58	22	22	5.8	25	0.6	10172	306	5075	23.4	5
221	STATE STREET	491	7186	45	71	71	4.1	23	0.9	NA	293	31524	17.4	6
222	GENENTECH	493	7167	59	11	11	4.0	65	0.0	969	118	2226	6.1	4
223	CHARLES SCHWAB	495	7160	41	68	68	8.3	29	0.5	NA	234	13779	28.9	6
224	COSTCO	499	7126	34	69	69	3.7	23	0.0	19566	249	4912	15.9	5
225	PANENERGY	504	7084	47	46	46	2.9	18	2.1	7537	361	8568	16.1	1
226	HILTON HOTELS	505	7047	28	5	5	2.2	40	1.1	5041	243	7577	5.5	5
227	WASHINGTON MUTUAL	507	7029	56	94	94	2.9	16	1.9	NA	409	44552	18.5	6
228	WILLIAMS	508	6995	44	32	32	2.1	20	2.4	3531	362	12419	10.5	1
229	AFLAC	510	6963	51	69	69	3.3	21	0.9	5910	346	25023	15.9	6
230	ITT	511	6944	60	-3	-3	2.3	23	0.0	6597	249	9275	9.9	5
231	WM. WRIGLEY JR. (8)	516	6872	59	13	13	7.5	29	1.9	1836	230	1234	25.6	4
232	DELTA AIR LINES	518	6857	94	13	13	2.5	-74	0.2	12455	156	12226	NEG	5
233	CABLETRON SYSTEMS	519	6856	44	21	21	8.2	26	0.0	14071	261f	951	31.2g	3
234	CONSOLIDATED EDISON CO. OF NEW YORK	520	6845	29	4	4	1.2	10	7.2	6960	694	14057	11.7	1
235	LOWE'S	522	6827	39	15	15	3.1	21	0.6	8600f	292f	4435f	14.5	5
236	KMART	525	6796	14	20	20	1.3	24	0.0	31437f	231f	14286f	5.4g	5
237	ASCEND COMMUNICATIONS	528	6732	56	NA	NA	12.2	55	0.0	549	113	652	22.1	3
238	BROWNING-FERRIS INDUSTRIES	531	6695	33	9	9	2.7	25	2.1	5779	273	7601	10.8	5
239	GREAT WESTERN FINANCIAL	532	6689	49	111	111	2.8	73	2.1	NA	116	42875	3.7	6
240	TRW	533	6661	54	14	14	3.1	15	2.3	9857	434	5899	19.9	3
241	AMERICAN STORES	535	6640	46	22	22	2.8	19	1.4	18678f	347f	7881f	14.8g	5
242	BANKERS TRUST NEW YORK	538	6620	85	13	13	1.5	12	4.7	NA	612	120235	12.8	6
243	NEWMONT GOLD	539	6619	40	-36	-36	4.2	59	1.2	1420	111	3350	7.1	8
244	COMERICA	541	6602	63	43	43	2.8	17	2.8	NA	417	34206	16.6	6
245	KROGER	542	6572	26	32	32	LOSS	19	0.0	25171	353	5825	NA	5
246	SALLIE MAE	545	6530	122	64	64	7.8	16	1.5	NA	419	47630	49.4	6
247	CLOROX	546	6524	126	48	48	6.9	27	1.8	2218	222	2179	25.7	4
248	DOVER	554	6467	57	21	21	4.3	17	1.2	4076	390	2993	26.2	7
249	DOMINION RESOURCES	561	6351	35	9	9	1.3	13	7.5	4842	472	14906	10.0	1
250	CNA FINANCIAL	564	6327	102	2	2	0.9	8	0.0	13479	965	54614	11.7	6
251	CARDINAL HEALTH (8)	565	6322	58	37	37	5.0	49	0.2	8862	112	2681	10.2	5
252	COGNIZANT	567	6302	37	NA	NA	7.2	30	0.3	1731	195	1875	23.8	5
253	LINCOLN NATIONAL	568	6283	61	30	30	1.4	13	3.2	3182	514	71713	11.2	6
254	ENTERGY	570	6268	26	0	0	0.9	10	6.8	7164	568	22966	9.4	1
255	MASCO	573	6250	39	24	24	3.4	20	2.1	3237	295	3702	17.2	2
256	ESTEE LAUDER (8)	579	6160	52	37	37	11.6	38	0.7	3195	160	1822	30.7	4
257	EATON	581	6157	80	38	38	2.9	17	2.2	6961	349	5307	16.3	3
258	ALLTEL	583	6133	33	4	4	3.0	17	3.4	3192	366	5359	17.7	5
259	FIRST USA (8)	588	6111	50	71	71	4.7	32	0.5	1634	247	7709	14.8	6
260	NEWMONT MINING	589	6107	39	-35	-35	4.2	58	1.2	1420	104	3350	7.1	8



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THE BUSINESS WEEK GLOBAL 1000

COUNTRY RANK		GLOBAL 1000 RANK	MARKET VALUE U.S. \$ MIL	PRICE PER SHARE U.S. \$	% CHANGE FROM 1996 (U.S. \$) (LOCAL)	PRICE/ BOOK VALUE RATIO	P/E RATIO	YIELD %	SALES U.S. \$ MIL	PROFITS U.S. \$ MIL	ASSETS U.S. \$ MIL	RETURN ON EQUITY %	INDUS- TRY CODE	
261	SYSCO	594	6082	35	2	2	4.3	21	1.7	13395	277	3325	20.2	5
262	NEWELL	595	6081	38	28	28	4.1	23	1.7	2873	256	3005	17.6	4
263	BECTON, DICKINSON	596	6056	49	16	16	4.8	21	1.1	2770	283	2890	22.4	4
264	DRESSER INDUSTRIES	598	6037	34	17	17	3.8	22	2.0	6533	258	6533	17.6	3
265	COOPER INDUSTRIES	599	6036	51	20	20	2.9	17	2.6	5284	315	5950	17.5	3
266	TRANSAMERICA	600	6034	91	12	12	1.6	14	2.2	NA	456	49875	11.2	6
267	GENUINE PARTS	601	6031	34	10	10	3.5	18	2.9	5720	330	2522	19.3	5
268	FEDERAL EXPRESS	609	5992	52	37	37	2.3	18	0.0	10274	308	6699	13.2	5
269	ST. PAUL	610	5982	72	35	35	1.5	10	2.6	4448	558	20681	14.3	6
270	LSI LOGIC	613	5945	42	35	35	4.5	39	0.0	1239	147	1953	11.6g	3
271	INGERSOLL-RAND	614	5971	55	30	30	2.9	16	1.5	6703	358	5622	18.2	3
272	COMPUTER SCIENCES	615	5918	77	-2	2	3.3	27	0.0	5616f	228f	2596	12.5g	5
273	COX COMMUNICATIONS (8)	616	5912	22	-3	-3	2.6	-63	0.0	1460	-52	5785	NEG	5
274	HBO	617	5897	64	NA	NA	11.1	69	0.1	797	74	849	16.0	5
275	PACIFICORP	618	5875	20	1	-1	1.5	13	5.4	4294	505	14635	11.6	1
276	EQUITABLE	619	5875	32	31	31	1.6	11	0.6	598	545	128811	15.1	6
277	UNION CARBIDE	621	5866	47	8	8	2.8	11	1.6	6106	593	6546	25.9	2
278	SALOMON	623	5861	54	28	28	1.3	8	1.2	NA	907	194881	16.3	6
279	BURLINGTON RESOURCES	625	5792	47	22	22	2.5	18	1.2	1293	255	4316	13.9	1
280	AES (8)	627	5754	72	159	159	7.7	41	0.0	835	125	3622	18.8	1
281	GUIDANT	628	5752	78	34	34	12.5	34	0.1	1049	150	1004	36.7	4
282	PUBLIC SERVICE ENTERPRISE GROUP	629	5741	25	-7	7	1.1	11	8.7	6041	587	16915	10.1	1
283	PIONEER HI-BRED INTERNATIONAL	630	5736	70	23	23	5.6	26	1.3	1721	223	1422	21.4	2
284	PARAMETRIC TECHNOLOGY	634	5724	45	2	-2	11.2	35	0.0	600	138	659	31.6	5
285	FREEPORT-McMORAN COPPER & GOLD	635	5722	28	-15	-15	17.2	27	3.2	1905	226	3866	64.6	2
286	RITE AID	636	5711	47	58	58	2.3	27	1.7	6970f	161f	6417f	8.6	5
287	WINN-DIXIE STORES	637	5699	38	11	11	4.3	26	2.5	12955	256	2649	16.9	5
288	PROGRESSIVE (8)	639	5681	79	71	71	3.3	18	0.3	3472	314	6184	17.9	6
289	PROVIDIAN	642	5664	60	37	37	1.8	13	1.8	1199	435	28993	14.5	6
290	COMCAST	643	5663	17	0	0	10.9	-65	0.5	4038	-53	12089	NEG	5
291	SUNAMERICA	645	5657	47	69	69	4.4	21	0.9	NA	274	23727	20.6	6
292	QUAKER OATS	647	5626	41	17	17	4.6	23	2.8	5199	248	4394	19.7	4
293	PEOPLESOFT	650	5615	52	NA	NA	22.0	144	0.0	450	36	540	15.3	5
294	ADVANCED MICRO DEVICES	651	5612	40	127	127	2.7	-67	0.0	1953	69	3145	NEG	3
295	TIMES MIRROR	654	5550	56	29	29	5.9	32	1.1	3401	205	3530	18.3	5
296	UNUM	657	5521	79	34	34	2.5	18	1.4	3120	238	15468	14.0	6
297	CINERGY	658	5519	35	18	18	2.1	16	5.1	3243	335	8849	13.1	1
298	OXFORD HEALTH PLANS	659	5506	71	NA	NA	9.1	50	0.0	3075	100	1347	18.2	5
299	SAFECO	661	5495	44	29	29	1.3	13	2.9	2541	439	19918	10.5	6
300	DIGITAL EQUIPMENT	663	5482	36	31	31	1.6	-12	0.0	14563	-112	10075	NEG	3
301	MCGRAW-HILL	665	5468	55	17	17	4.0	22	2.6	3075	250	3642	18.2	5
302	REPUBLIC NEW YORK	667	5464	100	58	58	2.0	14	1.8	NA	419	52299	14.4	6
303	BMC SOFTWARE	668	5462	54	72	72	14.2	34	0.0	563f	171f	608	42.1g	5
304	LIMITED	669	5460	20	-3	-3	2.8	18	2.4	8645f	316f	4120f	15.5	5
305	BAKER HUGHES	672	5454	38	20	20	3.2	22	1.2	3028	216	3297	14.9	3
306	LIBERTY MEDIA	673	5452	22	9	9	2.3	5	0.0	1339	1056	3059	41.2	5
307	R. R. DONNELLEY & SONS	678	5407	37	1	1	3.3	21	2.1	6599	277	4849	16.2	5
308	INTIMATE BRANDS (8)	681	5366	21	2	-2	13.3	20	2.4	2997	258	1135	65.9	5
309	ROHM & HAAS	682	5356	86	27	27	3.4	15	2.1	3982	363	3933	22.2	2
310	NORTHERN TRUST (8)	683	5332	49	79	79	3.7	21	1.5	1744	259	21608	17.6	6
311	TRIBUNE	685	5309	43	17	17	4.3	19	1.5	2406	283	3701	22.7	5
312	COASTAL	686	5305	50	22	22	1.8	11	0.8	12167	500	11613	16.4	1
313	AMERICA ONLINE	689	5284	55	NA	NA	10.0	11	0.0	1094	30	959	NEG	5
314	MGIC INVESTMENT (8)	691	5264	45	51	51	3.7	20	0.2	750	258	2222	19.0	6
315	CAROLINA POWER & LIGHT	693	5262	35	-4	4	2.0	14	5.4	2996	391	8369	13.6	1
316	UST	697	5234	29	-14	-14	18.6	12	5.7	1370	464	807	158.2	4
317	NUCOR	702	5183	59	7	7	3.2	20	0.7	3647	248	2620	16.2	2
318	THERMO ELECTRON	703	5180	35	-19	19	3.0	25	0.0	2933	191	5141	11.9	3
319	PHELPS DODGE	704	5178	84	22	22	2.0	12	2.4	3787	462	4816	16.0	2
320	SHERWIN-WILLIAMS	709	5151	30	34	34	3.7	22	1.3	4133	229	2995	16.6	2
321	GATEWAY 2000	711	5120	67	NA	NA	6.3	19	0.0	5035	251	1673	32.2	3
322	CVS	713	5103	48	36	36	5.4	30	0.9	5528	168	2832	16.0	5
323	USA WASTE SERVICES (8)	722	5060	36	23	23	4.4	104	0.0	1313	33	2831	4.2	5
324	CONSOLIDATED NATURAL GAS	727	5044	53	10	10	2.3	17	3.7	3794	308	6001	13.6	1
325	VF	730	4993	78	28	28	2.5	16	2.0	5137	300	3450	15.7	4
326	TELEPORT COMMUNICATIONS GROUP (8)	732	4987	30	NA	NA	5.9	-33	0.0	268	-115	2050	NEG	5
327	SONAT	733	4969	58	36	36	3.1	22	1.9	3395	201	3775	14.1	1
328	AMERADA HESS	735	4965	54	-6	-6	1.5	28	1.1	8272	236	7784	5.2	1

ENTRY RANK		GLOBAL 1000 RANK	MARKET VALUE U.S. \$ MIL.	PRICE PER SHARE U.S. \$	% CHANGE FROM 1996 (U.S. \$) (LOCAL)		PRICE/ BOOK VALUE RATIO	P/E RATIO	YIELD %	SALES U.S. \$ MIL.	PROFITS U.S. \$ MIL.	ASSETS U.S. \$ MIL.	RETURN ON EQUITY	INDUSTRY CODE
9	REYNOLDS METALS	737	4948	68	26	26	1.9	58	2.1	6972	104	7516	3.2	26
0	UNICOM	739	4920	23	-18	-18	0.8	8	7.0	6937	666	23388	10.7	12
1	INTERPUBLIC GROUP	740	4916	60	29	29	5.6	23	1.3	2538	205	4765	24.2	52
2	NORTHROP GRUMMAN	742	4909	85	35	35	2.3	19	1.9	8071	234	9422	12.0	31
3	MOLEX (8)	743	4901	39	53	53	4.2	31	0.1	1383	146	1461	13.6	35
4	GREEN TREE FINANCIAL (8)	744	4866	35	8	8	3.7	15	0.9	1276	309	3792	24.7	62
5	DIAMOND OFFSHORE DRILLING (8)	745	4865	71	49	49	3.9	26	0.0	611	146	1575	14.8	36
6	SUMMIT BANCORPORATION (8)	747	4861	49	36	36	2.4	16	2.9	1730	229	22668	15.4	61
7	HOUSTON INDUSTRIES	749	4852	21	-5	-5	1.3	10	7.2	4025	467	12288	12.8	12
8	INTERNATIONAL FLAVORS & FRAGRANCES	750	4842	44	-9	-9	4.5	22	3.3	1436	221	1507	20.2	22
9	BAY NETWORKS	757	4766	25	15	-15	4.1	-42	0.0	2057	206	1507	NEG	35
0	OMNICOM GROUP (8)	759	4740	58	33	33	6.0	24	1.4	2642	176	4056	24.4	52
1	TOSCO (8)	760	4737	33	98	98	3.2	33	0.7	9923	146	3555	9.7	11
2	CHAMPION INTERNATIONAL	762	4720	49	12	12	1.3	235	0.4	5880	141	9820	0.5	23
3	HERCULES	765	4708	47	-17	-17	5.4	14	2.1	2060	325	2386	38.8	22
4	CLEAR CHANNEL COMMUNICATIONS (8)	766	4707	53	30	30	9.0	101	0.0	352	38	1325	8.9	51
5	GENERAL DYNAMICS	768	4676	75	22	22	2.8	17	2.2	3581	270	3299	16.1	31
6	MBIA	774	4652	107	41	41	1.9	14	1.4	252	322	8562	13.4	63
7	ALTERA (8)	775	4643	53	119	119	11.2	43	0.0	497	109	778	25.8	35
8	EASTMAN CHEMICAL	776	4633	60	-11	-11	2.8	14	3.0	4782	380	5266	20.3	22
9	UAL	777	4623	78	37	37	4.6	11	0.0	16362	600	12677	42.6	56
0	TORCHMARK	781	4564	66	55	55	2.8	15	1.8	1610	319	9801	19.3	63
1	EQUIFAX (8)	785	4537	31	26	26	10.0	24	1.1	1811	178	1303	40.8	62
2	ALLEGHENY TELEDYNE	786	4530	26	31	31	5.2	19	2.5	3816	227	2606	27.2	71
3	MORTON INTERNATIONAL	788	4516	32	19	19	2.5	32	1.5	2215	179	2861	NA	22
4	CENTRAL & SOUTH WEST	789	4508	21	-23	-23	1.2	10	8.2	5464	447	13332	12.0	12
5	JEFFERSON-PILOT	790	4503	64	24	24	2.0	14	2.5	994	294	17562	14.3	63
6	CIENA (8)	791	4499	47	NA	NA	21.6	77	0.0	55	15	67	28.1	34
7	SYNOVUS FINANCIAL (8)	793	4496	26	68	68	5.6	30	1.4	1033	140	8612	18.6	61
8	ADT (8)	798	4477	29	51	51	4.1	77	0.0	1704	-687	2730	5.4	52
9	ARCO CHEMICAL	799	4475	46	-11	-11	2.2	15	6.1	3955	348	4394	14.4	22
0	ADC TELECOMMUNICATIONS (8)	800	4473	34	49	49	7.1	49	0.0	828	87	769	14.5	55
1	DUN & BRADSTREET	802	4467	26	11	11	LOSS	-373	3.4	2159	-27	2294	NA	52
2	FLUOR	806	4448	53	-19	-19	2.7	32	1.4	11015	268	3952	8.2	38
3	TYSON FOODS (8)	811	4432	21	26	26	2.8	37	0.5	6454	87	4544	7.5	44
4	NEW YORK TIMES	814	4408	46	40	40	2.8	23	1.4	2615	179	3540	12.2	51
5	MERCANTILE BANCORPORATION	817	4388	59	26	26	2.2	14	2.9	NA	248	18987	15.9	61
6	BB&T (8)	821	4366	40	37	37	2.5	15	2.7	1874	284	21247	16.6	61
7	CASE	822	4354	59	NA	NA	2.3	13	0.3	5176	349	6059	17.2	38
8	CINCINNATI FINANCIAL (8)	823	4354	78	32	32	1.4	19	2.1	1809	224	7046	7.3	62
9	FIRSTAR (8)	826	4320	30	22	22	2.8	16	2.8	1798	250	19767	18.2	61
0	MIRAGE RESORTS (8)	832	4265	24	-17	-17	3.2	23	0.0	1358	206	2143	13.6	53
1	OWENS-ILLINOIS	834	4251	31	89	89	3.8	19	0.0	3846	191	6105	19.9	26
2	ANALOG DEVICES	835	4240	27	28	28	4.9	27	0.0	1194	172	1516	18.4	35
3	PECO ENERGY	836	4228	19	-23	-23	0.9	9	9.5	4284	517	15261	10.0	12
4	GPU	839	4223	35	4	4	1.4	10	5.7	3918	373	10941	13.7	12
5	CRESTAR FINANCIAL (8)	843	4191	38	35	35	2.3	17	3.1	1744	218	22862	13.6	61
6	RUBBERMAID	845	4179	28	0	0	4.1	29	2.2	2355	152	2054	14.3	41
7	CINCINNATI BELL (8)	851	4157	31	16	16	6.6	21	1.3	1574	185	1671	31.0	55
8	LEHMAN BROTHERS HOLDINGS	855	4141	41	67	67	1.2	11	0.6	NA	416	128596	10.8	62
9	WASHINGTON POST	856	4140	386	23	23	3.2	18	1.2	1853	221	1870	17.4	51
0	WILLAMETTE INDUSTRIES	860	4125	75	NA	NA	2.1	31	1.7	3425	192	4721	6.7	23
1	H. F. AHMANSON	863	4099	41	58	58	1.7	15	2.2	NA	290	49902	11.5	61
2	ADAPTEC (8)	865	4084	37	23	23	5.9	40	0.0	934f	108f	1043f	15.0	35
3	HUNTINGTON BANCSHARES (8)	871	4046	28	26	26	2.7	15	2.8	1717	262	20852	17.4	61
4	FIRST OF AMERICA BANK (8)	872	4044	46	51	51	2.3	15	2.7	1890	257	22062	15.4	61
5	NORTHWEST AIRLINES	874	4038	41	NA	NA	43.6	8	0.0	9881	536	8512	536.8	56
6	NATIONAL SEMICONDUCTOR	875	4020	28	73	73	2.4	30	0.0	2623	185	2658	8.2	35
7	SERVICEMASTER (8)	879	3990	33	52	52	4.1	19	2.1	3458	245	1847	21.8	52
8	W. W. GRAINGER	880	3988	80	20	20	2.9	20	1.4	3537	209	2119	14.9	59
9	PAYCHEX (8)	881	3986	37	25	25	16.8	57	0.7	325	52	220	29.6	52
0	KOHL'S (8)	882	3982	54	63	63	7.4	38	0.0	2388	102	1122	19.5	54
1	COMPUWARE (8)	885	3970	46	136	136	8.9	43	0.0	813f	97f	755f	20.8	52
2	REGIONS FINANCIAL (8)	886	3969	60	26	26	2.3	15	2.7	1580	230	18930	15.0	61
3	AMERICAN STANDARD (8)	890	3938	50	68	68	-6.3	20	0.0	5805	-47	3520	NEG	32
4	KNIGHT-RIDDER	891	3929	43	15	15	3.6	14	1.9	2775	268	2900	24.8	51
5	PARKER HANNIFIN	892	3919	53	29	29	2.8	16	1.5	3586	240	2887	17.8	37
6	XILINX (8)	894	3915	54	54	54	8.0	39	0.0	568f	110f	848f	20.7	35

COUNTRY		GLOBAL 1000	MARKET VALUE U.S.	PRICE PER SHARE	% CHANGE FROM 1996	PRICE/BOOK VALUE	P/E	YIELD	SALES U.S.	PROFITS U.S.	ASSETS U.S.	RETURN ON EQUITY	INDUS	
397	BEAR STEARNS	895	3904	33	41	41	1.8	8	1.9	NA	491	92085	22.4	62
398	AVERY DENNISON	899	3893	38	32	32	5.5	21	1.8	3223	176	2037	25.9	52
399	CIRCUIT CITY STORES	903	3878	40	21	21	2.5	29	0.4	7154f	137f	3008f	8.9	54
400	BALTIMORE GAS & ELECTRIC	904	3876	26	-4	-4	1.4	12	6.3	3153	373	8551	11.0	12
401	SOUTHRUST (8)	905	3873	39	42	42	2.1	14	2.6	1977	255	26223	14.8	61
402	DTE ENERGY	907	3863	27	-9	-9	1.1	14	7.7	3645	406	11015	7.9	12
403	GOLDEN WEST FINANCIAL	909	3857	68	23	23	1.7	11	0.7	NA	370	37731	15.7	63
404	AUTOLIV	912	3854	37	NA	NA	2.1	22	1.2	3204	177	3371	9.7	37
405	IKON OFFICE SOLUTIONS	915	3843	29	-42	-42	1.9	30	0.6	4100	165	5385	6.4	52
406	GLOBAL MARINE	916	3839	23	84	84	8.3	18	0.0	681	180	808	45.4	36
407	DILLARD'S	918	3833	34	-16	-16	1.5	16	0.5	6412f	239f	5060f	9.6g	54
408	TJX	920	3825	48	36	36	7.2	18	0.8	6689f	214f	2746	39.9g	54
409	W. R. GRACE	925	3794	52	3	3	6.5	20	1.1	3454	223	4946	31.9	22
410	EXEL	927	3788	44	28	28	1.8	8	2.9	518	494	5032	24.2	63
411	LINEAR TECHNOLOGY (8)	928	3780	50	45	45	7.0	31	0.4	378	134	530	22.9	39
412	NORDSTROM	930	3771	48	-6	-6	2.6	25	1.0	4453f	148f	2703f	10.2	54
413	DANA	932	3763	36	8	8	2.6	12	2.8	7686	306	6160	22.6	37
414	ANADARKO PETROLEUM	933	3756	63	17	17	3.7	36	0.5	569	92	2584	10.3	12
415	SOUTHWEST AIRLINES	937	3742	26	-6	-6	2.3	17	0.2	3406	207	3723	13.1	56
416	UNION ELECTRIC	938	3740	37	-7	-7	1.6	13	6.9	2260	305	6871	12.1	12
417	HASBRO	942	3714	29	15	15	2.3	19	1.1	3002	200	2702	12.0	46
418	WHIRLPOOL	943	3714	50	-12	-12	1.9	20	2.7	8523	175	8015	9.5	43
419	DOW JONES	944	3713	39	-1	-1	2.3	21	2.5	2482	190	2760	10.7	53
420	HUMANA	945	3707	23	3	3	2.9	27	0.0	6677	152	3153	10.7	52
421	ACE (8)	947	3694	64	30	30	1.6	11	1.1	849	290	4574	14.9	61
422	IMC GLOBAL	950	3677	39	7	7	3.1	20	0.8	2981	214	3437	15.5	22
423	MANPOWER	953	3656	45	16	16	6.1	24	0.4	6080	152	1752	25.6	52
424	STANLEY WORKS	956	3648	41	35	35	4.7	37	1.8	2671	97	1660	12.7	46
425	SABRE GROUP HOLDINGS (8)	957	3645	28	NA	NA	5.7	20	0.0	1622	187	1287	28.8	52
426	WESTERN ATLAS	959	3643	68	11	11	2.4	28	0.0	2583	126	2783	8.8	36
427	UNION CAMP	961	3636	53	0	0	1.7	101	3.4	4013	114	5096	1.7	23
428	UNIONBANCAL (8)	962	3635	66	29	29	1.6	16	2.1	2196	236	29234	10.2	61
429	CASCADE COMMUNICATIONS (8)	965	3613	38	-32	-32	14.9	-25	0.0	341	71	270	NEG	52
430	HOST MARRIOTT	969	3577	18	34	34	3.2	588	0.0	NA	-13	5152	0.5	53
431	STAPLES	972	3569	22	10	10	4.7	32	0.0	3968f	106f	1788f	14.7	54
432	COLUMBIA GAS SYSTEM	973	3563	64	32	32	2.2	16	1.6	3354	222	6005	14.1	12
433	NEXTEL COMMUNICATIONS	975	3561	15	-29	-29	1.3	-5	0.0	333	-556	6472	NEG	54
434	TRANSOCEAN OFFSHORE (8)	976	3555	69	30	30	2.2	29	0.3	529	78	2443	7.6	36
435	ASHLAND	977	3555	48	12	12	2.0	21	2.3	12145	163	7269	9.6	12
436	JOHNSON CONTROLS	979	3548	42	22	22	2.5	15	2.0	10876	228	5123	16.5	37
437	MARSHALL & ILSLEY (8)	982	3532	40	45	45	2.8	18	2.0	1042	203	14763	15.2	61
438	ENSCO INTERNATIONAL (8)	984	3531	50	64	64	4.0	30	0.0	469	95	1315	13.5	36
439	STAR BANC (8)	985	3529	41	78	78	4.3	22	1.9	885	158	10094	19.4	61
440	BROWN-FORMAN (8)	986	3527	51	26	26	5.2	21	2.1	1544	160	1381	24.8	43
441	HARRIS	987	3526	89	37	37	2.5	17	1.7	3621	178	3207	14.4	34
442	AUTOZONE	988	3526	23	-33	-33	4.1	21	0.0	2243	167	1498	19.8	54
443	PACCAR (8)	989	3520	45	84	84	2.5	16	2.8	4585	201	5299	16.1	42
444	LEGGETT & PLATT (8)	993	3504	38	33	33	3.6	21	1.4	2466	153	1713	16.7	43
445	BENEFICIAL	996	3477	64	10	10	2.2	13	3.2	NA	281	16931	17.3	61
446	MAXIM INTEGRATED PRODUCTS (8)	999	3440	54	58	58	8.2	29	0.0	422	123	418	28.7	37
447	H&R BLOCK	1000	3433	33	-5	-5	3.3	73	2.4	1680	177	1756	4.7	53

KEY TO INDUSTRY CODES Left-hand digit represents broad economic sector as defined by Morgan Stanley Capital International. Right-hand digit is industry classification code within each economic sector

- | | | | |
|--|---|---|---|
| 1. ENERGY
11. Energy sources
12. Utilities-electrical & gas
2. MATERIALS
21. Building materials & components
22. Chemicals
23. Forest products & paper
24. Metals-nonferrous
25. Metals-steel
26. Misc. materials & commodities
3. CAPITAL EQUIPMENT
31. Aerospace & military technology | 32. Construction & housing
33. Data processing & reproduction
34. Electrical & electronics
35. Electronic components & instruments
36. Energy equipment & services
37. Industrial components
38. Machinery & engineering
4. CONSUMER GOODS
41. Appliances & household durables
42. Automobiles
43. Beverages & tobacco | 44. Food & household products
45. Health & personal care
46. Recreation, other consumer goods
47. Textiles & apparel
5. SERVICES
51. Broadcasting & publishing
52. Business & public services
53. Leisure & tourism
54. Merchandising
55. Telecommunications
56. Transportation-airlines | 57. Transportation-road & rail
58. Transportation-shipping
59. Wholesale & international trade
6. FINANCE
61. Banking
62. Financial services
63. Insurance
64. Real estate
7. OTHER
71. Multi-industry
81. Gold mines |
|--|---|---|---|

- (5)
 pharmaceutical (JA-8)
 rt (JA-147)
 g (JA-174)
 marine (JA-122)
 BR-9)
 e Group (SWI-8)

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THE RUSSIANS ARE HERE, THE RUSSIANS ARE HERE

Moscow's stellar showing helps emerging markets rebound from the 1995 crash



A few years ago, only a small group of daring investors was willing to pour money into Russian stocks. Now, Russia is on the radar screen of virtually every emerging-market investor. As the Moscow market soared 124% and companies began issuing American depository receipts in 1996, Russia rocketed into BUSINESS WEEK's annual list of the top 100 emerging-market companies for the first time. With a market value of \$42.6 billion, Russia's Gazprom is just a hair behind No. 1 Telebrás, Brazil's phone giant.

Russia's stellar showing is due to a market boom driven by foreign funds. President Boris N. Yeltsin's reelection in July, 1996, reduced political risk and bolstered foreign investors' confidence in the security of property rights. Indeed, foreigners pumped close to \$3 billion into the Russian market in '96 and have added \$1 billion more so far this year. But the appearance of Russia Inc. on BUSINESS WEEK's list, which is compiled by Morgan Stanley Capital International, also reflects the sheer size

of Russian companies. Gazprom controls one-third of the world's gas reserves and has revenues of \$20 billion. Lukoil, ranked No. 20, outproduces Brazil's Petrobrás, No. 4 on the list. Says Peter Kizenko, senior equity trader at ING Barings in Moscow: "We're not talking about breadmakers here. These are mammoth industrial enterprises."

DISAPPOINTING. Across the board, 1996 was a good, but not stunning, year for emerging markets. They continued their rebound after the 1995 crash that followed Mexico's peso crisis. The International Finance Corp.'s emerging-market index rose 15% in 1996—somewhat disappointing compared with the 23% rise of the Standard & Poor's 500-stock index in the U.S. While Brazil's São Paulo index jumped 53% in dollar terms last year, shares of many leading Indian and Thai companies dropped, mostly because of political instability. In South Africa, the rand's plunge against the dollar as well

LUKOIL GAS Foreign investors, reassured by stability, fueled Moscow's boom

as depressed consumer spending hurt companies such as Anglo African Breweries Ltd., and Anglo American Corp.'s 9% decline in market value was linked to a slump in gold prices and escalating costs.

Even so, the market capitalization of emerging-economy bourses is nearly \$2.5 trillion, according to estimates by Merrill Lynch & Co. That's within whisker of Japan's total market cap, and the figure should be rising. The International Monetary Fund forecasts that developing economies will expand more than 6% this year and at the same rate again in 1997, double the expected pace of growth for the industrialized world. Such robust growth, along with a widespread feeling among analysts that emerging markets remain undervalued, will stoke investor interest and propel new entries onto the roster of the world's most valuable companies.

This year's Russian newcomers on the BUSINESS WEEK scorecard include not only the big and most liquid but also the most transparent companies

in the market. For example, Lukoil recently published Western-audited figures for 1994 and 1995 and will release numbers in July. Even secret Gazprom is now working with Western auditors. Both companies are privatized state giants that have managed to transform themselves into global players.

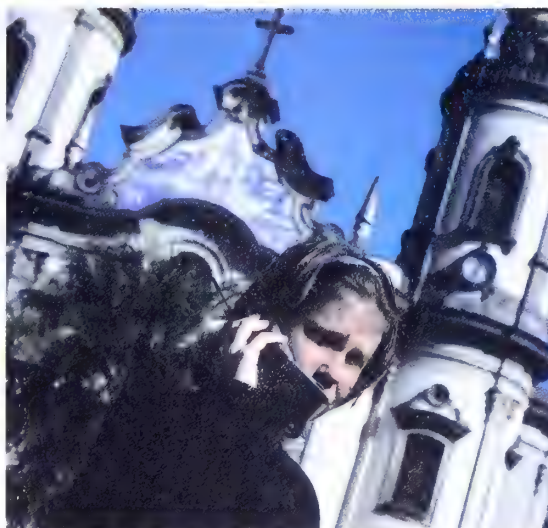
Excitement over privatization is helping emerging-market stocks soar on the opposite side of the globe as well. Two of the top six companies on the BUSINESS WEEK scoreboard are public-sector Brazilian companies. Their stocks have risen in tandem with price hikes as government fattens their profits to prepare them for full-scale privatization. This year's No. 1 company, telecom giant Telebrás, rose a dramatic 109% in market value on the BUSINESS WEEK

stors snapped up the stock in anticipation of its planned breakup sell-off next year. Its privatization, probably Latin America's best, could pull in \$25 billion in investments over the next three years, analysts say.

While Russia and Brazil soared in 1996, markets elsewhere coped with volatility provoked by everything from local instability to a global slump in chip prices. Thailand suffered from investors' angst about the economy, where a bubble in the property market burst, hit banks and other companies. At the same time, political unrest rocked the market in Indonesia.

NORRIA. Taiwan, too, was badly shaken when China launched missile tests near the island in March, 1996. The market rebounded smartly after news of a possible clash with China faded. The country's stock index, the TAIEX, rose 34% last year. Apart from calmer political waters, Taiwan's inclusion in Morgan Stanley Capital International indexes sparked a wave of norria as foreign institutions channeled more funds into the market.

In Korea, by contrast, several companies were hit hard by last year's 80% fall in prices of computer dynamic random-access memory chips (DRAMs). For example, profits at Samsung Electronics



Co. dove 93%, to \$184 million, on sales of \$17.8 billion, as the company slipped 11 notches down BUSINESS WEEK's list, to No.24. Korean companies also suffered from the yen's weakness, which boosted the competitiveness of Japanese rivals in autos, steel, shipbuilding, and petrochemicals.

After a rocky 1996 and first quarter of 1997, Korea's market is now recovering, however. The KOSPI index is up 22% since its low in March. Indeed, Korea is

SAO PAULO CALL Telebrás' planned sell-off sparked its 109% rise in value

one of several emerging markets where analysts bet on a continued upswing. They are also encouraged by South Africa, where the government is now easing exchange controls and is expected to speed up privatization soon. And analysts are high on India, where interest rates are falling and the economy should grow 6.5% this year. One hot stock is Hindustan Lever Ltd., a maker of personal-care products that ranked No.45 on BUSINESS WEEK's list. Investors are betting that rising incomes in India will fuel a surge in consumer spending.

As the U.S. market continues to ride high, daring investors will no doubt keep up their search for hidden values in emerging markets. "The emerging markets offer an upside potential that doesn't exist in the U.S.," says Douglas Johnson, senior international investment strategist for Merrill Lynch in New York. In Russia, farsighted investors are looking beyond Gaz-

prom and other blue chips to smaller telecom companies and utilities. In Brazil, they're eyeing private companies. Next year's emerging-market stars are already in the making.

By Patricia Kranz in Moscow, with Dave Lindorff in Hong Kong, Ian Katz in São Paulo, and bureau reports

The Top 100 Emerging-Market Companies

RANK 1996		COUNTRY	MARKET VALUE U.S. \$ MIL	PRICE PER SHARE U.S. \$	%CHANGE FROM 1995 (U.S. \$) (LOCAL)		PRICE/ BOOK VALUE RATIO	P/E RATIO	YIELD %	SALES U.S. \$ MIL	PROFITS U.S. \$ MIL	ASSETS U.S. \$ MIL	RETURN ON EQUITY %	INDUSTRY CODE
2	TELEBRAS	Brazil	43300	130	NA	NA	1.6	16	1.4	11667	2575	39378	9.9	55
NR	GAZPROM	Russia	42612	18	NA	NA	0.8	7	0.2	20031	5759	NA	10.8d	12
8	ELETRORAS	Brazil	25536	472	94	108	0.4	11	1.9	5694	2236	86314	3.9	12
15	PETROBRAS	Brazil	23134	194	169	189	1.1	33	0.7	16973	625	32762	3.4	11
1	KOREA ELECTRIC POWER	Korea	19361	31	-20	-9	1.0	29	1.6	12988*	670*	40005*	3.5	12
11	TELECOMUNICACOES DE SAO PAULO (TELESP)	Brazil	19020	343	62	74	2.0	23	2.8	3352*	759*	11860*	8.7	55
6	TELEFONOS DE MEXICO (TELMEX)	Mexico	18867	2	34	43	1.7	14	3.0	6656	1465	13310	11.9	55
4	CATHAY LIFE INSURANCE	Taiwan	16020	5	-2	-2	9.6	43	1.0	NA	374	NA	22.3	63
7	PT TELEKOMUNIKASI INDONESIA	Indonesia	15731	2	11	15	4.3	24	1.0	2087	618	7311	18.0	55
3	TELEKOM MALAYSIA	Malaysia	14798	7	-19	-18	3.1	20	0.9	2554	749	7957	15.6	55
9	TENAGA NASIONAL	Malaysia	14135	5	8	8	2.2	38	0.7	3242	318	12930	5.7	12
5	ANGLO AMERICAN	South Africa	13695	59	-10	-7	2.4	11	2.3	NA	984	7831	21.1	81
NR	UNIFIED ENERGY SYSTEM	Russia	13668	0.3	412	412	2.0	13	0.3	28943b	1068b	NA	15.4	12
10	DE BEERS CONSOLIDATED MINES	South Africa	13314	35	8	10	1.4	10	3.0	NA	1275	NA	13.6	26
12	MALAYAN BANKING	Malaysia	12059	11	11	12	5.4	24	0.6	NA	428	37491	22.5	61
44	TAIWAN SEMICONDUCTOR MFG.	Taiwan	11381	4	110	112	9.2	16	0.0	1414	696	NA	56.4d	34
17	FIRST COMMERCIAL BANK	Taiwan	11194	4	17	18	7.6	55	0.6	NA*	202*	NA	13.7	61
23	YPF	Argentina	10560	30	36	36	1.6	12	2.9	5922*	817*	10147*	13.5	11
26	HELLENIC TELECOMMUNICATIONS ORGANIZATION	Greece	10531	25	50	69	5.3	24	1.9	2188b	448b	NA	22.5	55
NR	LUKOIL	Russia	10371	15	82	82	1.2	16	0.4	7108	671	NA	7.7	11
14	HUA NAN BANK	Taiwan	10336	4	2	3	7.0	58	0.7	NA*	179*	NA	12.2	61
19	CHANG HWA COMMERCIAL BANK	Taiwan	10216	4	17	18	7.7	60	0.6	NA*	170*	NA	12.8	61
18	SOUTH AFRICAN BREWERIES	South Africa	8953	28	-8	-5	4.9	21	2.3	8266c	435c	4706	23.6	43
13	SAMSUNG ELECTRONICS	Korea	8801	75	-14	-2	1.5	47	0.9	17807*	184*	17766*	3.2	41
20	VALE DO RIO DOCE	Brazil	8586	22	5	13	0.9	16	1.6	4404	483	16297	5.7	25
28	TELEFONICA DE ARGENTINA	Argentina	8491	4	23	23	2.4	22	2.9	2753	385	5806	10.6	55
7	GUDANG GARAM	Indonesia	8305	4	6	11	9.4	31	0.7	2696	269	1609b	30.5	43
3	UNITED MICROELECTRONICS	Taiwan	7930	3	93	95	5.4	27	0.0	811	273	NA	19.8	35

Based on nonconsolidated results. a) Based on 1994 data. b) Based on 1995 data. c) Based on 1997 data. d) Difference between earnings and book value between 12 and 18 months. SS=Negative ratio. NA=Not available. NEG=Negative return. NM=Not meaningful

RANK 1997 1996		COUNTRY	MARKET VALUE U.S. \$ MIL	PRICE PER SHARE U.S. \$	%CHANGE FROM 1995 (U.S. \$) (LOCAL)		PRICE/ BOOK VALUE RATIO	P/E RATIO	YIELD %	SALES U.S. \$ MIL	PROFITS U.S. \$ MIL	ASSETS U.S. \$ MIL	RETURN ON EQUITY %	INDU CO
29	29	CHINA STEEL	Taiwan	7855	1	14 15	2.0	19	4.3	3071*	407*	NA	10.3	2
30	27	BANCO BRADESCO	Brazil	7681	8	22 31	1.5	10	3.6	NA	770	36220	14.8	6
31	33	SIME DARBY	Malaysia	7587	3	22 22	3.5	24	1.9	4290	272	10557	14.4	7
32	36	SASOL	South Africa	7407	12	23 26	3.0	13	2.5	3031	557	4059	23.9	2
33	NR	ELETRICIDADE DE SAO PAULO (ELETROPAULO)	Brazil	7353	238	NA NA	2.1	64	0.0	4011*	158*	NA	3.2	1
34	59	PORTUGAL TELECOM	Portugal	7301	38	59 75	3.1	23	2.1	2634	318	5060	13.4	5
35	70	NAN YA PLASTICS	Taiwan	7214	3	83 85	4.4	26	1.5	NA	279	NA	17.1	2
36	35	LIBERTY LIFE ASSOCIATION OF AFRICA	South Africa	7059	28	-3 -1	2.1	20	2.6	1733	344	15629b	10.3	6
37	68	CHINA DEVELOPMENT	Taiwan	6979	4	69 70	6.8	38	1.0	NA*	184*	NA	17.8	6
38	NR	TELECOMUNICACIONES DE CHILE (CTC)	Chile	6915	8	55 60	3.4	18	2.4	1292	359	4469	18.5	5
39	51	BANCO ITAU	Brazil	6666	514	27 36	1.8	12	2.4	NA	553	NA	15.6	6
40	42	GENCOR	South Africa	6571	4	12 15	1.8	9	1.4	NA	403	5147	18.7	8
41	21	PETRONAS GAS	Malaysia	6526	4	17 -17	5.7	20	1.7	503c	332c	2325	28.9d	1
42	52	PEREZ COMPANC	Argentina	6443	8	34 34	3.5	22	1.5	1474	288	3167	15.9	7
43	45	UNITED ENGINEERS (MALAYSIA)	Malaysia	6393	8	16 17	NA	30	0.3	1355	204	1918b	NA	7
44	NR	BANCO DO BRASIL	Brazil	6293	9	3 5	1.2	-1	0.0	NA*	-7032*	NA	NEG	6
45	91	HINDUSTAN LEVER	India	6234	31	40 43	25.5	58	1.1	941b*	67b*	453b*	44.1	4
46	31	POHANG IRON & STEEL	Korea	6172	66	-4 8	0.8	9	1.7	9473*	700*	16081*	9.4	2
47	43	AYALA	Philippines	6149	1	37 38	5.9	26	0.2	NA	236	2142b	23.0d	7
48	NR	COMPANHIA SANEAMENTO BASICO SAO PAULO (SABESP)	Brazil	6088	238	NA NA	0.9	70	NA	2252*	54*	NA	1.2	5
49	16	BANGKOK BANK	Thailand	6068	6	39 40	1.4	7	4.0	NA	835	41775b	19.1	6
50	57	TELEFONICA DEL PERU	Peru	5981	3	29 43	3.7	16	2.6	1174	338	1744b	22.3	5
51	84	CEMIG	Brazil	5948	46	73 85	0.7	32	2.0	1791*	197*	11483*	2.2	1
52	49	COPEC	Chile	5927	5	19 22	1.6	25	1.1	3000	223	4696b	6.1	1
53	47	ENDESA	Chile	5913	1	16 19	2.0	17	5.7	1156	337	6261	12.2	1
54	82	FORMOSA PLASTICS	Taiwan	5681	2	61 62	4.2	26	1.3	1576	219	NA	16.0	2
55	64	STANDARD BANK INVESTMENT	South Africa	5382	45	23 26	2.9	16	2.0	NA	346	NA	18.7	6
56	54	CIFRA	Mexico	5372	2	25 32	2.7	21	1.8	2936	256	2160	13.0	5
57	67	CERVEJARIA BRAHMA	Brazil	5370	730	22 31	4.2	18	1.4	2221	304	NA	23.2	4
58	34	SHIN KONG LIFE INSURANCE	Taiwan	5299	3	-5 -4	6.1	25	1.7	NA	214	NA	24.5d	6
59	131	COMPANHIA ENERGETICA DE SAO PAULO (CESP)	Brazil	5270	56	116 132	0.4	-12	0.0	2240*	-480*	23081*	NEG	1
60	NR	NACIONAL TELEFONOS DE VENEZUELA (CANTV)	Venezuela	5261	5	NA NA	1.8	12	0.5	1433	430	NA	15.1	5
61	55	REMBRANDT GROUP	South Africa	5256	10	13 16	2.4	14	1.7	NA	331	2710	16.9	4
62	58	TELECOM ARGENTINA	Argentina	5249	5	14 14	2.2	20	4.0	1931*	260*	5220*	10.9	5
63	85	LIGHT-SERVICOS DE ELETRICIDADE	Brazil	5199	500	52 63	2.3	29	1.5	1476*	162*	3126*	7.9	1
64	30	GRUPO CARSO	Mexico	5188	6	28 36	3.7	12	1.8	NA	417	3371	31.3	7
65	71	GRUPO MODELO	Mexico	5076	6	31 39	2.8	29	0.4	1486	158	NA	9.4	4
66	60	SAN MIGUEL	Philippines	4965	2	18 18	2.8	21	1.6	3223	199	3297b	13.5	4
67	79	TATUNG	Taiwan	4829	2	29 30	4.0	18	1.2	NA	266	NA	22.3	7
68	61	CEMEX	Mexico	4809	4	-1 5	1.4	5	2.2	3348	1090	9340	27.8	2
69	75	MAHANAGAR TELEPHONE NIGAM	India	4788	8	28 31	6.3	20	0.7	984*	204*	NA	30.8	5
70	NR	SURGUTNEFTGAZ	Russia	4770	1	216 216	0.9	15	0.7	NA	336	NA	6.0d	1
71	48	KIMBERLY-CLARK DE MEXICO	Mexico	4731	3	-6 -0	4.1	17	2.9	1150	269	1734	24.7	4
72	72	ENERSIS	Chile	4554	1	18 21	2.8	16	3.8	2771	253	9875	17.0	1
73	NR	TELECOMUNICACOES RIO DE JANEIRO (TELERJ)	Brazil	4518	154	NA NA	1.6	62	2.6	1167*	60*	NA	2.5	5
74	158	AKBANK	Turkey	4516	0.1	108 274	7.7	12	3.6	NA*	267*	NA	64.0	6
75	73	STATE BANK OF INDIA	India	4513	9	7 9	2.4	13	1.1	NA*	233*	NA	18.4	6
76	53	GRUPO TELEvisa	Mexico	4421	14	7 -1	3.3	-57	0.0	1454	-76	3708	NEG	5
77	46	INTERNATIONAL COMMERCIAL BANK OF CHINA	Taiwan	4351	2	-15 -15	3.7	26	0.6	NA*	165*	NA	14.2	6
78	96	NEDCOR	South Africa	4350	19	41 45	3.2	16	1.9	NA	242	NA	19.7	6
79	55	METROPOLITAN BANK & TRUST (METROBANK)	Philippines	4230	23	6 5	3.5	22	0.6	NA	190	NA	15.9	6
80	83	INDOFOOD SUKSES MAKmur	Indonesia	4122	2	5 10	3.8	24	0.7	1162	144	1522b	15.8	4
81	190	ACER	Taiwan	4099	3	105 106	3.6	34	0.0	4134	110	NA	10.6	3
82	56	PTT EXPLORATION & PRODUCTION	Thailand	3981	13	-14 -15	7.9	93	0.4	214	43	816b	8.6	1
83	92	RELIANCE INDUSTRIES	India	3909	8	24 27	1.7	11	2.1	2440c*	370c*	4194*	16.0	2
84	78	LIBERTY HOLDINGS	South Africa	3794	77	4 6	1.9	19	2.6	NA	202	15787b	10.4	6
85	100	AMALGAMATED BANKS OF SOUTH AFRICA	South Africa	3724	6	22 25	2.1	14	2.6	NA	253	NA	15.4	6
86	87	GENTING	Malaysia	3661	5	-39 -38	2.7	16	1.1	1033	227	2310b	16.5d	5
87	82	RESORTS WORLD	Malaysia	3650	3	-42 -42	3.9	16	1.7	838	227	1202b	23.9d	5
88	129	TEVA PHARMACEUTICAL INDUSTRIES	Israel	3648	59	33 37	6.6	45	0.6	913	70	NA	14.6	4
89	86	ANGLO AMERICAN INVESTMENT TRUST	South Africa	3647	36	8 11	2.5	10	3.8	NAc	373c	1381	25.9	2
90	40	HM SAMPOERNA	Indonesia	3635	4	-35 -32	6.3	22	1.4	948	162	NA	29.3	4
91	74	MANILA ELECTRIC	Philippines	3600	3	-2 -2	2.0	16	2.5	2164	186	1949b	12.9	1
92	139	COPEL	Brazil	3568	15	54 65	0.9	19	3.1	1004*	181*	5829*	4.8	1
93	105	ALFA	Mexico	3546	6	26 34	1.7	8	1.6	3514	496	4974	19.9	7
94	NR	TELECOMUNICACOES DE MINAS GERAIS (TELEMIG)	Brazil	3528	142	NA NA	1.9	13	0.0	997*	237*	NA	14.9	5
95	NR	BANK OF THE PHILIPPINE ISLANDS	Philippines	3473	6	25 26	NA	23	0.7	NA	151	NA	NA	0
96	118	UNIBANCO	Brazil	3456	35	28 37	1.5	12	3.2	NA	266	NA	13.2	6
97	87	VIDESH SANCHAR NIGAM	India	3456	35	-17 -15	3.9	20	0.4	1231*	112*	NA	19.3	5
98	104	FIRST NATIONAL BANK HOLDINGS	South Africa	3395	8	17 20	2.7	13	2.3	NA	224	NA	20.3	6
99	80	GRUPO FINANCIERO BANACCI	Mexico	3388	2	-5 1	1.4	-52	0.0	NA	-61	2477	NEG	6
100	38	PAKISTAN TELECOMMUNICATIONS	Pakistan	3286	1	-45 -36	2.4	10	2.3	936*	315*	NA	23.2	5



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GOING BEYOND CITY LIMITS?

Municipalities are exercising their clout on social issues—and business is balking

On June 1, the city of San Francisco began requiring companies with which it does business to offer benefits to domestic partners of employees. At a June 21 meeting of the Conference of Mayors, Mayor Edward J. Boyle of North Olmstead, Ohio, exhorted his fellow leaders to pass a

police. Local governments are foisting their social vision on industry by passing bold laws that give them a say in everything from human-rights issues to compensation. Says Dennis Aftergut, chief assistant to the San Francisco city attorney: "Like any private company doing business, we should have the right

ness must offer all its employees, regardless of location, the same benefits that married workers get. Advocates of such initiatives applaud their sweeping application, noting that cities must fill a void left by a less interventionist federal government. "The backdrop for all this is a retrenchment of the public

sector playing a social role," says Amy Dean, founder of Working Partnerships, a group in San Jose, Calif., that pushes living-wage initiatives. **TEST CASE.** Opponents, however, say this trend is worrisome: It lets city hall play national politics—a role they deem inappropriate at best and unconstitutional at worst. "How can the city of San Francisco, with a jurisdiction of 49 [square] miles, pass a law that has an impact across the U.S.?" asks Brendan Dolan, a lawyer representing the airline industry in a lawsuit challenging San Francisco's domestic-partner initiative. "Why should a company somewhere in Maine be subjected to San Francisco telling them how to treat their employees?"

In what could be an important test of a municipality's power to

LOCAL ACTIVISM

LIVING WAGE A dozen cities, including Baltimore, Los Angeles, and New York, require companies doing city business to pay more than the minimum wage.

DOMESTIC PARTNERS

San Francisco is demanding that contractors offer employees' domestic partners the same benefits that workers' spouses enjoy. Los Angeles and New Orleans are considering similar measures.

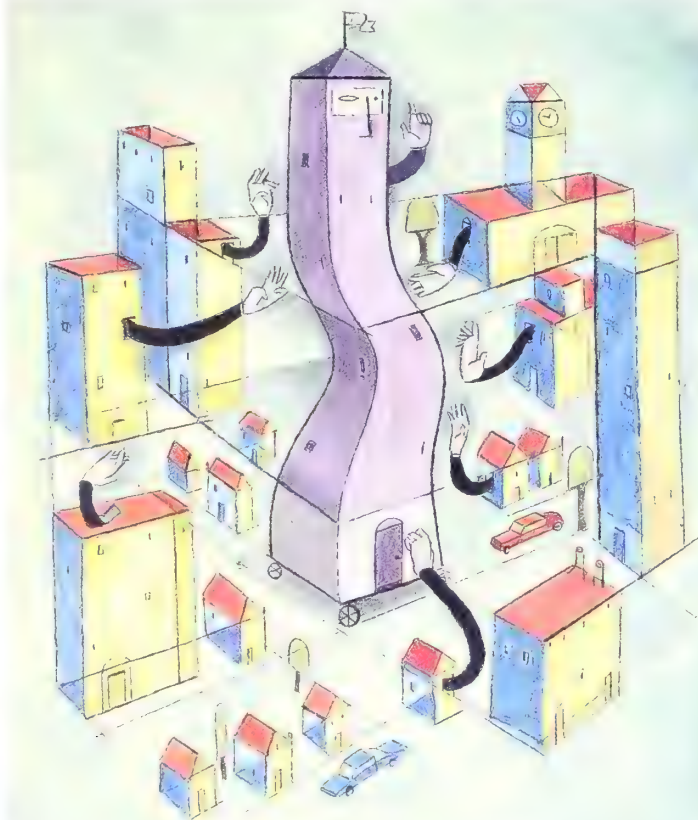
SMOKING From Fort Worth to Lynn, Mass., cities are restricting the use, sale, and advertising of tobacco products.

HUMAN RIGHTS Four counties in Northern California ban localities' purchase of goods or services from companies with ties to Burma.

DATA: BUSINESS WEEK

pose social regulation on business, the Air Transport Assn., representing airlines, challenged San Francisco's domestic-partner law in mid-May. Other companies, including BankAmerica, Pacific Telesis, and Chevron, have complied with the ordinance, but the airlines say federal regulation preempts any local authority over the industry.

The suit, which came after United



resolution, adopted in February by his Cleveland suburb, that would ban cities from buying goods or services made with child labor or under sweatshop conditions. And starting on July 1, city contractors in New Haven must pay workers \$7.43 an hour—\$2.68 more than the federal minimum wage.

These days, municipalities are pushing their clout way past potholes and

to decide who we do business with and on what terms."

The growing awareness that city hall can use its pocketbook to wield power over business—politically and economically—is leading to adoption of laws that affect how multinational corporations function. San Francisco's domestic-partners ordinance, for instance, states that any company with ties to city busi-

nes Inc. negotiated a two-year lease an Francisco International Airport, and serve as an important gauge of how far local laws can go when it comes to federally regulated industries and multinational corporations. United mainly on the grounds that upholding the law would interfere with its ability to serve its customers because it inappropriately links the use of airport gates and counter service to providing domestic benefits.

KLASH? Elsewhere, conflicts may have reached the courts, but cities' resentment is brewing. In New York, George B. Clark says his janitorial service, which has contracts with the city, could suffer as a result of the minimum wage requirement. Under the regulations, it will be harder for Clark to pay his workers \$5.50 to \$6 an hour when city jobs pay more. In Fort Worth, Michael S. Thomson, a restaurateur who fought a law that gives restaurants until 2000 to either ban smoking on their premises or install air-purification systems, says the city should leave such matters to municipal governments. "We're not in the business," says Thomson. "This is my private business." He says a new ventilation system would cost \$15,000—an amount he believes many businesses have trouble covering.

Of course, this isn't the first time cities have thrown their weight around. In the 1980s, many localities adopted laws restricting investments by public pension funds in outfits operating in South Africa. And recently, business has successfully fought back several initiatives to legislate social policy. Last fall, for instance, Denver voters defeated a measure that would have raised the city's minimum wage to \$6.85 an hour. But today, activism is more widespread than in the past and is reaching deeper into core corporate policy. For instance, advocates of social activism say, companies have raked in tax incentives and subsidies from municipalities where they want to do business. Now, it's payback time. Many lawmakers hope cities will find more ways to use their collective buying power. Since passing his no-tobacco ordinance, for instance, North Carolina's Governor James I. Boyle has seen his bill pass in other Cleveland suburbs—and in San Francisco. Although the mayors' opposition tabled the measure for further study, he's working on signing up other cities, such as New York, Philadelphia, and Austin, Tex. To critics who say municipalities are overstepping their authority, Boyle says: "It's not that local government shouldn't be doing this. It's that all governments should be." Until a city says otherwise, business can expect a lot more of the same.

by Linda Himmelstein in San Francisco, with bureau reports

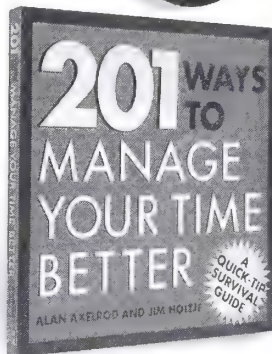
Brilliance China Automotive



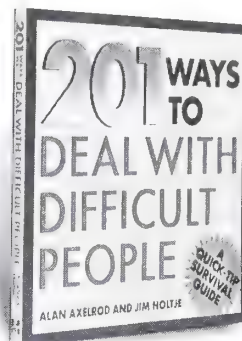
Brilliance China Automotive Holdings Ltd. (the "Company") (NYSE: CBA) was established in 1992 to own a 51% interest in Shenyang Jinbei Passenger Vehicle Manufacturing Co., Ltd. ("Shenyang Automotive"), a leading manufacturer and distributor in the growing minibus

market in China. The Company was the first with operations solely in China to list directly on the New York Stock Exchange. Shenyang Automotive's main products are the low-priced Standard Minibus and the luxury Deluxe Minibus. It has dominated the luxury minibus market in China, and in 1996 successfully launched mid-priced models aimed at the fast growing minibus market. Shenyang Automotive's products have been consistently ranked as the most technologically advanced in China.

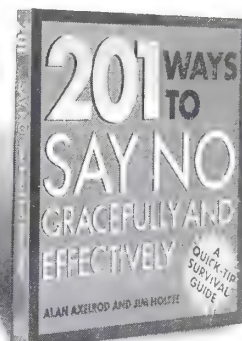
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Illustration: Tom McGraw-Hill's company

HP PICTURES T

The king of computer printers is set to take on the likes of Kodak and Canon and carve out a chunk of the \$40 billion photography market

It's summer, and gadget freaks are on the prowl in photo and electronics emporiums for a hot new camera to snag young Molly's first dive off the high board. The options are many: There's Eastman Kodak, of course, and Nikon, Canon, Hewlett-Packard. Hewlett-Packard? The printer guys? Say what? Say cheese, says HP—and then print out that smile right in the comfort of your own home.

the future—printing out near lab-quality snaps, at home, in as much time as it takes to brew a cup of coffee.

If HP succeeds, this could shake up the photo-film industry and help revolutionize the way camera buffs and amateurs alike develop, distribute, even use what we will increasingly call “images” rather than photos. Crows HP's ordinarily staid chief executive, Lewis E. Platt: “It will fundamentally change the way people think about photography.”

No more schlepping to the photo store. No more trips back for duplicate prints. And, thanks to the global reach of the Internet, no more dropping those prized pictures into an envelope that you keep forgetting to mail to the relatives. PhotoSmart users are already getting a glimpse of what lies ahead. Since May, these customers have not only been snapping digital pictures but also plugging existing photos, slides, and negatives into a personal computer with HP's \$499 PhotoSmart scanner. Then, with a click of the mouse, the \$499 PhotoSmart printer spits out a crisp snap.

And that's just the start. Next year, HP will push further into photo territory when it delivers a printer that can download pictures direct from a digital camera—no more mucking around with a PC. And then comes a battery of other whizzy devices over the next few years, including a “digital mailbox” that will attach to the Net so you can zap photos and other im-

Cover Story

Hewlett-Packard Co., the world's second-largest high-tech company, best known for its printers and precision instruments, is an unlikely player in the hotly competitive, \$40 billion photography market. But get ready for a shootout. HP's recent debut of a new line of PhotoSmart digital photography gear is just the beginning of a bold new strategy that will pit it against the snapshot might of Kodak, Canon, Fuji, and other photo kings.

That's not to say that HP expects to sell a mountain of cameras right away—or ever. Its \$399 PhotoSmart digital camera is little more than a one-year-old model licensed from Konica Corp. that doesn't eclipse any of the camera heavyweights. Rather, HP's camera entry is part of a stealth approach aimed at turning its gear into the “home digital darkroom” of

PRINTING NEW MONEY

PROJECTED INDUSTRY REVENUES IN 2000
IN MILLIONS OF DOLLARS

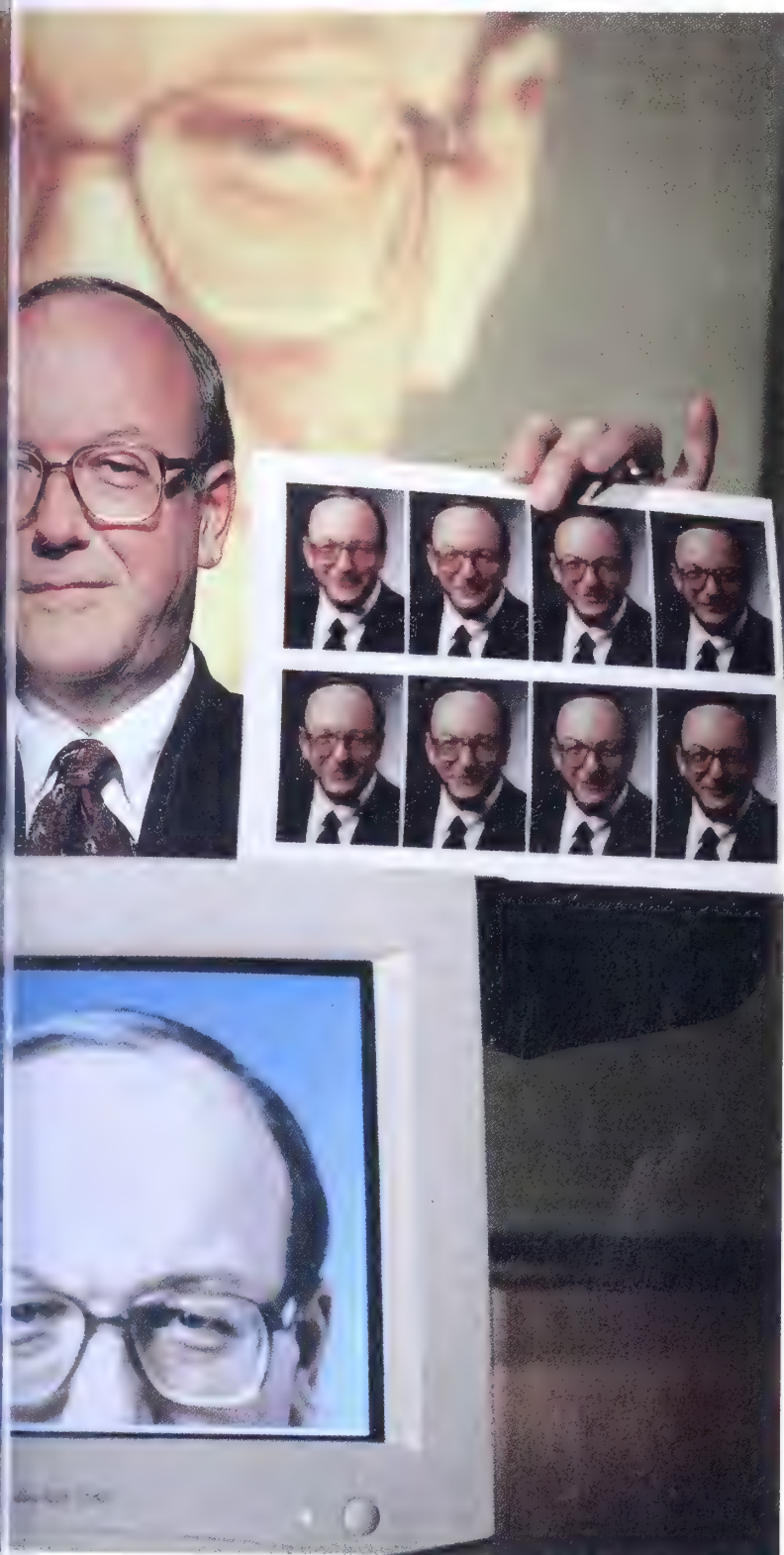
	PRINTERS	PAPER	INK
LARGE-FORMAT PRINTING	\$566	\$1,800	\$2,700
Posters, signs, billboards			
DIGITAL PHOTOGRAPHY*	4,140	148	805
COLOR COPIERS	3,120	726	2,060
DIGITAL PRESSES	120	148	447
Direct mail, brochures, product sheets			
TEXTILE PRINTING	36	NA	293
Clothing, fabrics			

*PHOTO-ONLY PRINTERS

DATA: IT STRATEGIES



FUTURE



ages into the homes of your far-flung family; and a camera-cellular phone combo for taking snaps of Timmy's game-winning homer and speeding them over the Net and into Grandma's hands before he even takes off his muddy cleats.

Then there's what HP has planned on the photo front for businesses. Over the next decade, the Silicon Valley giant plans to leverage its expertise in computing, its commanding market share in printing, and batches of new Net technologies simmering in its labs to turn today's workaday PC printer into the catchall printing press of the Information Age—churning out everything from professional quality posters to brochures for electronic publishers.

"HP MOMENT?" Has HP, the mild-mannered high-tech company known for its pocket-protector culture and gentlemanly ways, gone bonkers? Without question, this will be an uphill battle. HP may be the premier PC printer company, but it has yet to prove itself beyond the computer-savvy crowd. For this strategy to take hold, HP must not only learn the ropes of the mass consumer market—which is already strewn with generations of yellow-and-black film boxes—but it must persuade consumers to change their old photo ways. Just so, says Kodak CEO George M. C. Fisher. "I find the idea that HP is somehow going to take over photography somewhat humorous," he snorts. "People know what a Kodak moment is, but an HP moment? I don't think so."

He has a point. While Fisher concedes new, low-cost printers from HP "will validate the market for desktop photography," he is adamant that Kodak—not HP—is the company best poised to reap the benefits of a photo revolution (page 108). For one thing, Kodak is putting more than \$500 million a year into digital photography—about 10 times HP's investment. And Kodak offers a range of digital cameras, including the much-lauded \$999 DC120.

What's more, Kodak is no slouch when it comes to the picture possibilities in cyberspace. The photo giant is planning a host of new digital products that include a Net-based service due out this year called Kodak Picture Network. This service will let Netizens store their photos on the Web for a \$4.95 monthly fee so

IMAGE CONSCIOUS: *CEO Platt aims to revolutionize photofinishing with new digital equipment and services*

FILM? PHOTO SHOP? WHO NEEDS 'EM?



AT SONNY'S HOUSE HP, along with many other companies, sells digital cameras so shutterbugs can easily crop, print, and save photos on their home PCs. HP and its partners are developing technology so photo-quality images—not the grainy Internet pics of today—can be zapped over the Web with a few mouse clicks.



DIGITAL SCANNER

Given the poor resolution and high price of today's digital cameras, this will be HP's biggest market near-term—scanning precious old photos into PCs, where they can be cleaned up and put online.



friends can then view or download them. "It's going to be an explosive business, and we're going to be a primary source," vows Fisher.

But not the printing source, counters Platt. This is Kodak's blind spot. Although the photo giant offers more than 100 digital products, it has no home printer. Fisher, however, says Kodak might one day make a printer or license an existing model to resell under its own name should the home photo-quality printer market take off. **BILLIONS OF SNAPS.** HP has no doubt it will. HP is convinced digital photography will be a red-hot market—but not one that destroys the old-fashioned way of taking snaps. Indeed, HP expects that digital tech-

ers, an \$8.6 billion market in 1996, which accounted for 70% of all computer printers sold. And then there's desktop publishing. When HP leapt in with laser printers in the mid-1980s, commercial printers laughed. But within a few years, small businesses and consumers were dashing off newsletters and party invitations. "Once you put technology in people's hands, they will find more things to do than you can imagine," says Joshi.

Besides, to hear Platt tell it, HP can win big even if competitors don't lose. HP is ramping up spending for its grand scheme: The inkjet division, which is at the heart of its imaging plan, expects to more than double its plant, research and development, and marketing investment, to \$7.5 billion, over the next four years. But Platt says HP would have spent much of that on its printers anyway. So, even if digital photography doesn't gobble up the film and photo-processing market, just a 5% to 10% share would be a boost for HP. "I don't know if digital photography will ever be 90% of the market," says HP Chief Financial Officer Robert P. Wayman. "But the opportunity is so big, I don't care."

HP could use a boost. Faced with slowing growth in its core printing business and lackluster performance from its computers, the company is feeling the heat. Wall Street drove its shares down 11%, to 52, following the May 16 announcement that revenue growth for the second quarter

had slowed to just 5%, from 33% the same quarter a year ago—the fourth disappointing quarter in a row. In part, HP is a victim of its own success: It claims 45% of the inkjet printer market—double that of its closest competitor, Canon. And in laser printers, it has a staggering 62% share. "They've got the Campbell's Soup problem," says Morgan Stanley.

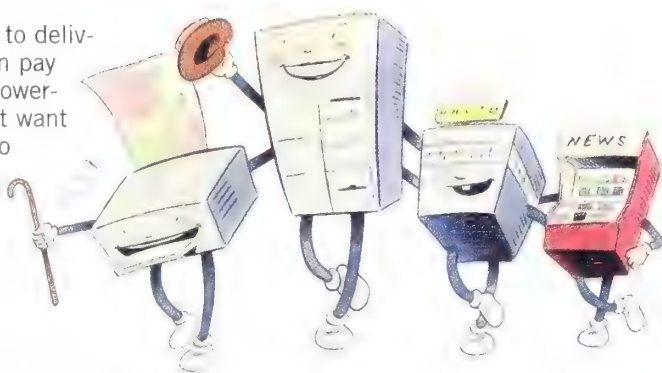


Cover Story

niques will expand the number of photos from 60 billion a year today to hundreds of billions in five years. By then, 50% will be printed at home, says HP's Vyomesh Joshi, general manager of the home imaging division. And HP, natch, is banking its printers will handle the bulk of them.

Sound far-fetched? Not when you consider HP's track record for turning niches into huge markets. Take inkjet printing. In the early 1980s, it was messy and inferior, but HP kept tweaking it, developing retail outlets, and hammering at costs. Today, HP is the No. 1 maker of inkjet print-

AT BUSINESSES Publishers that want to deliver information electronically, rather than pay postage or delivery costs, would need powerful image servers. Ditto for retailers that want to send the latest coupon or brochure to their customers—or photo shops that want to store customer photos online.



ON THE ROAD HP envisions hybrid camera/cell phones and is developing technology so pictures could be easily sent over the airwaves to a printer or image server.

analyst Steven M. Mich. "They own their categories." and overall growth in the categories is slowing. Printer sales growth dropped to 6% in 1996, from 16% the previous year, according to International Data Corp. An even bigger problem: Falling prices for inkjet printers lowered HP's revenue growth last year, even though unit sales grew by 40%.

That's why HP is pulling out the stops to drive up printer usage. It's marketing as never before to its 50 million current customers to get them to soak up more ink and paper each year. And the company is exploring every possible imaging opportunity, from digital photography to the tiniest of niches—like bakery sup-

plier Sweet Art Co., of Lenexa, Kan., which sells printers for decorating cakes.

What's behind all this razzle-dazzle? Credit the inkjet printer technology developed decades ago but improved upon by an HP skunkworks team holed up in a mop closet. It may seem humdrum, but inkjet cartridges are based on supersophisticated technology: They use semiconductors to heat hundreds of tiny chambers of ink until a bubble grows and bursts, forcing ink out a nozzle no wider than a fraction of a human hair. This technology has gone through a metamorphosis involving increasingly efficient and reliable micromechanics and high-speed manufacturing, thanks to HP's investment of more than \$500 million each year. Although Epson America Inc. has a related technology called Piezo that can now put down more dots per inch than HP's thermal inkjet process, HP's reliability has helped it dominate the desktop printer market.

Now the inkjet cartridge is not only at the heart of the PhotoSmart printer, but it's the key weapon in the bulk of new imaging products HP

is planning. And that, say HP execs, could lead to an ink-and-paper cash cow that would make Coca-Cola Co. or Gillette Co. proud. In 1996, printers accounted for an estimated \$11.6 billion in revenues, or 30% of HP's \$38.4 billion in total sales. If all goes as HP plans, analysts say, HP's printer business could grow 15% each year over the next five years.

MEGA MARGINS. But the real payoff is in printer paper and ink. Consider this: A snapshot uses 10 times the ink of an average text page, and an 8-by-10-inch picture uses 20 times the ink. Today, inkjet supplies are just 5% of HP's revenues, say analysts. But, with gross margins of 67%, vs. 33% for the overall company, they account for a stunning 25% of HP's profits. If HP executes its grand plan, the paper and ink business could grow 50% a year over the next two years, says analyst John B. Jones Jr. of Salomon Brothers Inc. "If we can get people to print one extra color page a week, we can double the size of our paper and ink business," says Srinivas Sukumar, head of HP's Internet Imaging group.

That has some experts salivating. While the company's sales growth dropped to between 5% and 12% in the past three quarters, CFO Wayman says inkjet printing, along with a new push in enterprise computing, could fuel annual growth of 16% to 19% for the next five years. At that rate, says analyst Jones, HP could supplant IBM as the largest tech company by 2004.

It will take much to get there. This

If HP pulls off its grand plan, the lucrative paper and ink business could grow 50% a year over two years

PEREZ' GOAL: TRIPLE HP'S PORTFOLIO OF INKJET PRINTERS

CAN YOU PLUG ALL TYPES OF PEOPLE INTO ONE TYPE OF COMPUTER?





No.

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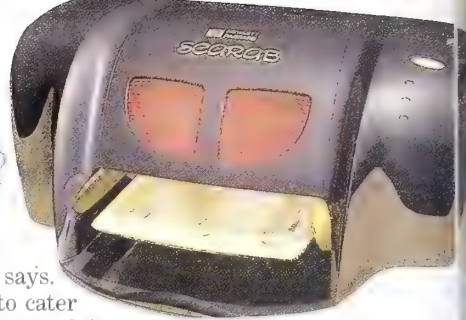
And if you're the one paying for the system, you spring for just as much computing power as you need for each employee. Not less, not more. And your employees end up with the tools they need to get their jobs done.

Windows is, above all, flexible.

So, let's rephrase the question. Can you plug all types of people into one operating system?

Yes.

HP has to overcome entrenched consumer habits. Will shutterbugs really prefer the home printer to the photo shop?



IN THE LABS: FUTURISTIC DESKJETS, CODE-NAMED SCARAB

strategy not only requires flawless execution, but HP's technical wizards must crank out new products at a furious pace to keep its paper-and-ink gold mine on the upswing. Inkjet chief Antonio M. Perez vows that by 2000, HP's portfolio of inkjet printers will triple, to 150, including kids' models

"We're like Neanderthals," he says.

Even if HP figures out how to cater to the masses, it may still be thwarted by entrenched consumer habits. Instead of dropping film off at the photo store, HP is convinced you'll prefer to zap your snaps into a home printer. And then there's getting consumers to routinely use the Net to swap photos with loved ones. Ridiculous, says Hirozo Ueda, executive vice-president of Fuji Photo Film Co. "People don't have so much time to mess around with home printing," he says.

Today, digital photo gear is a \$3 billion business—just a fraction of the total photo market, according to CAP Ventures Inc. That has as much to do with technology as it does consumer

habits. For starters, digital cameras have been no match for their tech brethren—and won't be for at least five years, say analysts. Pictures taken with Kodak's DC camera have just 1 million pixels, short of the 20 million in the average 35 millimeter snapshot. And a 360,000-pixel PhotoSmart camera is even worse. What's more, digital prints tend to fade in direct sun, they're more expensive: A 4-by-6 inch silver halide print costs 80¢ to 50¢ for a PhotoSmart snapshot.

But behind the scenes, HP is hard at work on fixes. Insiders say it has

digital camera-price combos in the labs that will break the 1 million-pixel mark for \$1,000 next year. HP's paper unit is dealing with ink makers on longer-lasting inks. HP execs also insist that getting the word out of a digital printer is a low silver halide. It's just a matter of time. "After all, they have to use silver, and we don't," says HP's John. There are signs: Inkjet owners are prime targets to give home photography a shot. A study of 19,000 households by IDC shows that the number of PC owners who want to use their computers to shoot pictures rose from 19% in 1995 to 29% in 1996 and could hit 38% next year.

HP also is doing some heavy lifting to get more high-resolution images onto the Net. Today, most online images are grainy pictures with just 72 bits of information—any more would mean longer waits for irritated

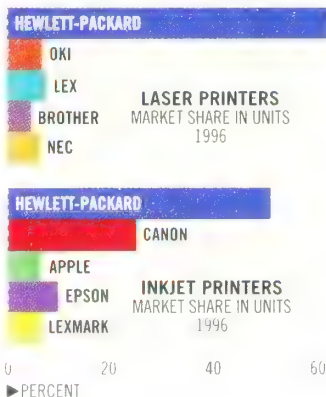
Cover Story

and futuristic designs now in HP's labs.

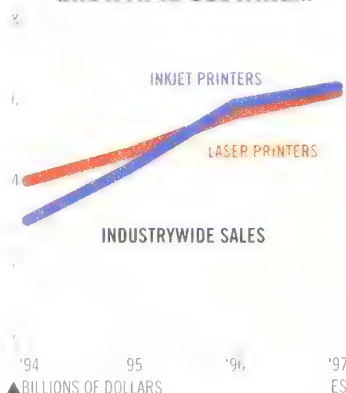
The newest addition: a DeskJet that's designed to work with Microsoft Corp.'s WebTV settop box rather than a PC. With this printer, due out this year, even neophytes surfing the World Wide Web can plan an evening out by quickly finding out a current movie guide. HP is hoping to make that as easy as flipping channels by working with TV manufacturers to add a "print" button as a standard remote control feature.

OLD HABITS. But perhaps the biggest challenge to this new imaging push is that HP's marketers must start thinking like sneaker and soda-pop peddlers. That's because success will mean not only providing cool tools but making sure they aren't so complicated that customers get spooked. The early returns on the PhotoSmart line, for example, show kudos for the devices' high quality, but even HP has admitted the scanner is a headache to hook up. Andrew E. Tallian, HP's North American consumer marketing manager, says that HP has a lot to learn about talking directly to consumers.

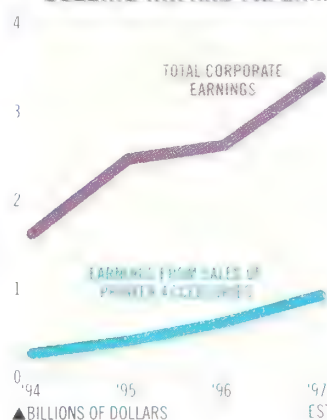
HEWLETT-PACKARD IS THE PREMIER PRINTER COMPANY...



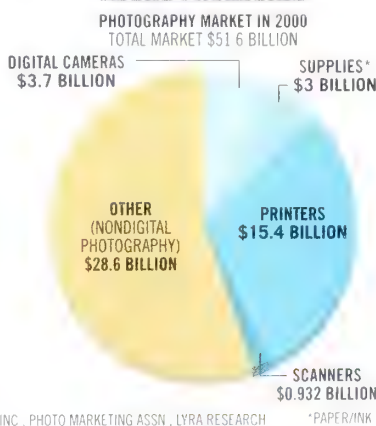
...BUT PRINTER SALES GROWTH IS SLOWING...



...AND MAKES A MINT SELLING INK AND PAPER...



...SO DIGITAL PHOTOGRAPHY LOOKS PROMISING



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Soon, travelers may be able to print out E-mail and other info at the airport or hotel with the swipe of a credit card

MY FIRST INKJET? MOCKUP OF AN HP KID PRINTER

delivers an 8-page synopsis of the newspaper to subscribers. Unlike a fax, the material will print in high resolution and in color—and for the publisher, it's a free call, just like E-mail.

HP believes customers are hungry for this kind of convenience. So starting this summer, execs-on-the-go will be able to drop into one of the 150 Kinko's outlets across the country

that have HP large-format printers, download their design work off the Net, and print it. No more lugging poster-size presentations on a plane—just pick them up at the local copy shop when you get where you're going. The oversize color printing market "is a \$10 billion business, somebody by 2000, and we're going to get it with HP," vows Wendell Anderson, operations chief of Kinko's Inc.

Web surfers. So HP joined with Kodak, Microsoft, and Live Picture, a Scotts Valley, Calif., software maker, to develop a technology called FlashPix that hit the market last summer. FlashPix enables an image to be sent over the Net in any of four levels of resolution—giving Netizens a choice. That wipes out the frustration for unknowing Web surfers and encourages Web-site operators to post the snazzy stuff.

NO-BRAINER. Now HP is going a step further, with a set of technologies code-named OpenPix. With these, software developers, who create all those digital images, will no longer have to convert their existing creations into a special FlashPix format. Instead, OpenPix makes the millions of existing computer images Net-ready.

Such technologies are crucial to HP's grand plan for widespread electronic distribution of all types of images via the Web. Today, for example, HP is trying to find ways to help publishers of everything from junk mail to glossy magazines deliver their goods online. For some businesses, it's a no-brainer. Electronic delivery would wipe out postage, printing, and distribution costs. And, since there's no need for setup time on printing presses, publishers could quickly customize their offerings—say a car brochure with all the models in a customer's favorite color.

To help make this a reality, HP plans to roll out a new technology in August called JetSend, which will extend home and small-business printing to the masses who don't own PCs. JetSend-compatible printers will attach directly to a phone line and have a Net E-mail address, just like a PC. "My customers wouldn't even have to log on," says Stephanie Serino, business manager of *The New York Times'* TimesFax service, which

WHAT KODAK IS DEVELOPING IN DIGITAL PHOTOGRAPHY

Eastman Kodak Co. holds a commanding lead in the photography market. But in the Digital Age, not even the mightiest companies are safe. Kodak Chairman George M. C. Fisher, recruited in 1994 from Motorola Inc., knows that all too well. He's pushing the \$16 billion company to act more like a Silicon Valley start-up. How? By rolling out new digital products every six months. With sales of high-tech gear such as digital cameras and scanners already at \$1.5 billion and surging 25% last year, he's pumping nearly half of Kodak's annual \$1.1 billion research and development budget into the digital future. Says Fisher: "There's a tremendous opportunity to expand the whole [photography] category."

You bet. And, by the way, Hewlett-Packard Chairman Lewis E. Platt thinks so, too. But Fisher and Platt could hardly be further apart on their images of the future. Sure, HP is going head-to-head against Kodak with digital cameras, scanners, and Internet services. But Platt thinks Hewlett-Packard's printer technology will snatch a major share of the emerging digital markets from traditional film providers. Fisher, on the other hand, thinks HP's printer, along with a wide array of new digital photography products and services from Kodak and others, will spur sales of Kodak film and boost Kodak's profits by at least 10% a year.

Is the printer going to replace the photo lab, a fixture of daily life for more than 100 years? Nonsense, says Fisher. HP, he suggests, "is preoccupied up in the hype of the technology." Still, with the mid-May launch of its \$499 PhotoSmart printer, HP attacked Kodak at a potentially vulnerable spot: the market for photo home printers. Kodak makes a printer for nearly every segment of the market save this one.

But Fisher isn't worried. Behind the scenes, Kodak engineers are working to produce a steady flow of new products for consumers, retailers, and professionals that offer a wide array of options for organizing, viewing, improving, and sharing pictures. Kodak's vision includes everything from cameras and scanners, software, and peripherals to turn the home PC into a digital photo room, to digital services that can be accessed at home or in retail outlets. "The advantage we have," says Fisher, "is we touch everybody's picture."

If Fisher has his way, that advantage will be true in cyberspace. In 1997, the Kodak Picture Net will debut. For \$4.95 a month, consumers will be able to download their photos scanned at home to a retailer and manipulate them either off-the-shelf software or Adobe Photo Shop, or Kodak's own software, including a program for eliminating red-eye that can be downloaded and used for a fee. C

at's just a slice of what the Net is possible. HP is noodling smart-equipped kiosks for airports and, for example, so executive road-ers can collect printouts of their E-mail, magazine articles, or di-ns to their hotel—all with the e of a credit card. HP's Apr. 23 sition of smart-card device com-VeriFone Inc. was a major step rd making this a reality. "We have 50% share of the PC printer et today, but we have only 1% to f the printing opportunity," says Perez.

rt and parcel of expanding in the consumer and small-busi-markets is making these prod-more visible and available. In a t deal with retailer Fred Meyer

Inc. in Seattle, HP inkjet cartridges are now stocked along with gift wrap and phone cords. Indeed, HP plans to make inkjet cartridges as easy to find as film by expanding distribu-tion from 7,000 computer and office supply stores today to 100,000 or more outlets by 2002, including gro-ceries, pharmacies, and department stores. Of course, that will only work if HP can cut cartridge costs from around \$30 today to a price more in line with film. "We have to make inkjet printing dirt cheap," says Perez.

And this fall, HP plans to unveil a campaign to shift its reputation as a reliable nerd into something more akin to General Electric Co.'s "We bring good things to life." An early

peek at this new HP came on June 25 at Pier 59 Studios when it marched out comedian Penn Jillette and lookalikes of Jerry Seinfeld and pal Elaine to pitch HP's grand imaging plan. "It's not exactly naked dancing girls, but it's a different approach for HP," says Internet marketing chief William J. Murphy.

Not only different, it could be the

Cover Story

start of an ambitious new strategy to define an HP moment.

By Peter Burrows in Palo Alto, Calif., with Geoffrey Smith in Rochester, N. Y., and Steven V. Brull in Tokyo

either print the pictures ne or have high-quality le by sending them elec-to a local photo shop or a odak lab.

turn of the century, predicts 75 billion photos taken an-be digitized at local photofin-l consumers will receive tra-ints and, for a small extra onic access to their pictures. Fisher maintains that con-l continue to take the ma-heir snapshots using tradi-because it will remain the and highest-quality method

of taking pictures for the next decade.

Still, the digital world is coming, even for the computer-wary. Kodak execs say consumers won't need a PC to reap the benefits of high-tech pho-tography. Kodak has already installed 10,000 Image Magic Print Stations at retailers and plans to install another 20,000 by next year. That way, rela-tives who live far away can go to an Image Magic station, use the Kodak Internet service to call up an image on the Web, fiddle with it to their lik-ing, and print it on the spot.

Even the digital cameras are be-ing improved upon. Today Kodak

sells a wide range of these gizmos, priced from \$199 to \$20,000, netting the company a 25% share of the market. Now Kodak is exploring a range of new gear, including cameras that can send pictures over cellular phones and photo-quality fax ma-chines. "Digital technology is going to create a whole new way of taking pictures," says Robert Unterberger, president of Kodak's Digital & Ap-plied Imaging unit.

Still, analysts say it will be years before home photo printing becomes as easy, inexpensive, and high-quality as traditional photo processing. The

reason: Manipulating photos on a computer may be convenient, but it's also time-con-suming. "The real question," says Steven Hoffenberg, director of the digital photo advisory ser-vice at Lyra Inc., a Newtonville, Mass., consulting firm, "is whether people prefer to make their own prints at home or drop off negatives and memory cards at retailers." His view: Kodak is primed to play both sides of the market.

But as Fisher un-derstands, in the dig-ital age, advantages can disappear in a flash.

By Geoffrey Smith in Rochester, N. Y.

TWO DIFFERENT FOCUSES

HEWLETT-PACKARD

KODAK

THE PLAN

able to print photos at home
photo printers, ink, and paper.

Combine the high quality of film with loads of digital products, including the ability to store, edit, and order reprints on the Net.

DIGITAL CAMERAS

a year-old model made by
or \$399.

A line of top-rated models, from professional to cheapies.

OTHER PHOTO GEAR

99 PhotoSmart scanner lets
r buffs scan old snapshots,
r negatives into their PCs.

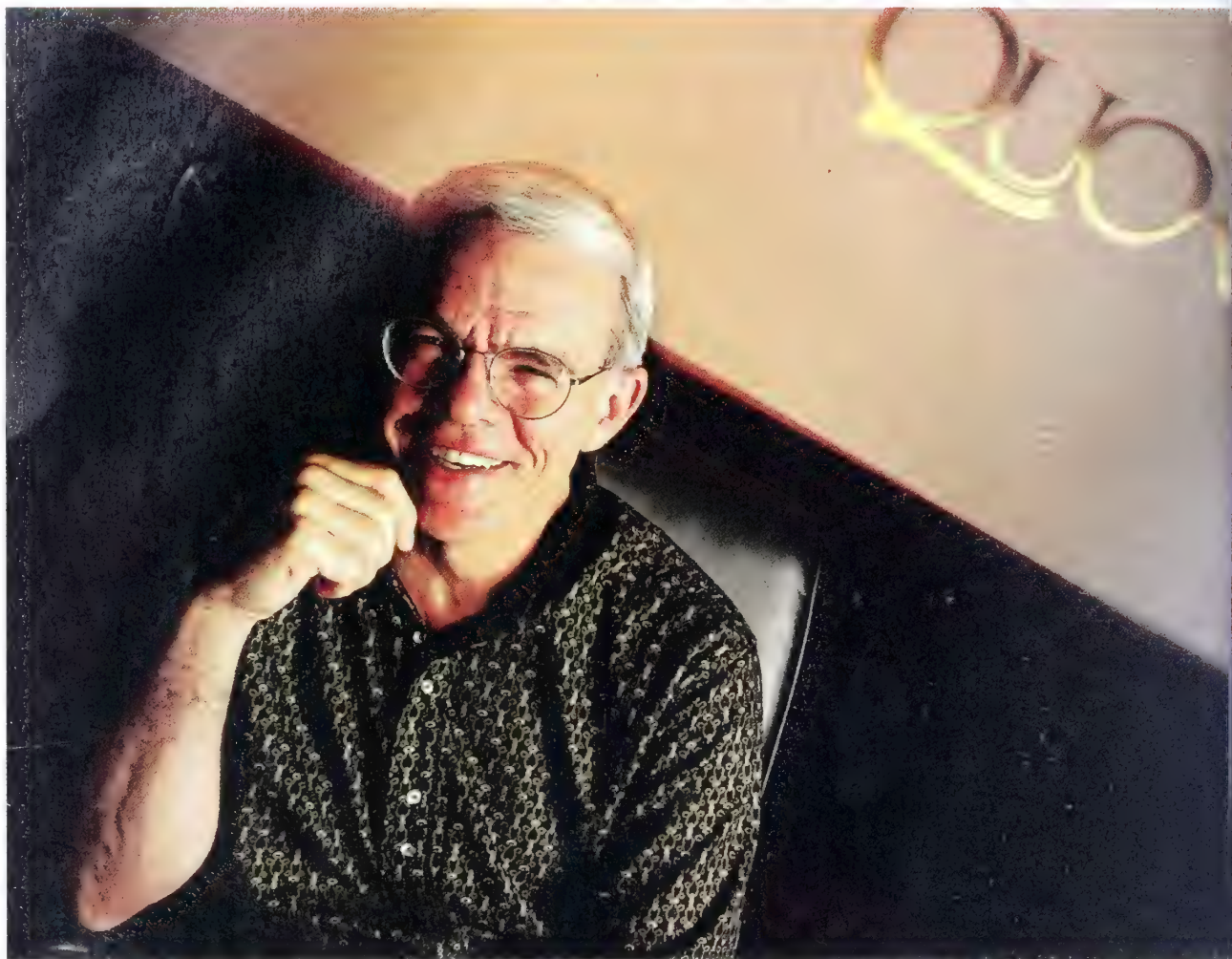
A range of equipment, including film-
processing gear and high-speed scanners,
so photo shops can offer digital services.

INTERNET STRATEGY

it standards to make it easy to zap
quality photos across the Web. Also
photo labs provide online storage
for shutterbugs who don't want to
their hard drives.

Become the top Web source for photography
services on the Net. Consumers can access
numerous digital services through Kodak's
Picture Network site for a monthly fee
of \$4.95.

DATA. COMPANY REPORTS



STRATEGIES

HEALTH CARE'S KINDER CONQUEROR

Quorum allays community fears—unlike rival Columbia

By his own admission, Paul "Pete" Strobel doesn't know beans about for-profit health care. But the 87-year-old retired steelworker does know one thing: He hates Columbia/HCA Healthcare Corp. Strobel organized a petition drive to keep the giant hospital chain from buying his hometown hospital in Massillon, Ohio, fearing that Columbia would shut it down. "I did everything in the world to get that outfit out of town," he says.

In that sort of grassroots opposition,

which Columbia faces in community after community, lies opportunity for Quorum Health Group Inc., a Brentwood (Tenn.) company that has styled itself as the nice-guy hospital chain. In April, Columbia was forced to rescind an offer for Massillon Community Hospital by the Ohio attorney general. Now, Quorum is the odds-on favorite to win when new bids are collected this summer.

Quorum has always taken a low-key approach to acquiring hospitals and assimilating them into the corporate fold.

By contrast, Columbia has often unnerved target companies with its insistence on tight centralized control as well as offended local citizens with its secrecy and take-it-or-leave-it negotiating style. Now it is increasingly running into opposition from regulators and lawmakers. In March, news broke that the U.S. government had begun a sweeping investigation of Columbia's Medicare billing and physician-referral practices. "Quorum is viewed much differently than a Columbia or Tenet [Healthcare Corp.] in that they are basically seen as benign," says Dan Bourque, senior vice president at VHA Inc., a trade association for 1,400 not-for-profit health organizations across the country.

GOOD MANNERS. Quorum's good manners have come at a cost: It has not achieved nearly the same heft and scale as Columbia. With earnings last year of \$69.2 million on revenues of \$1.2 billion, Quorum is a pip-squeak compared with Columbia, which earned \$1.5 billion on sales of \$19.9 billion in 1996. That reflects the differences in their portfolios: Quorum owns 18 hospitals to Columbia's 100.

Quorum, with its network of alliances in the not-for-profit sector, is uniquely positioned to gain from the backlash against Columbia

CEO DALTON: HANDLING ACQUISITIONS WITH DIPLOMATIC SAVVY

bia's 344. Quorum also isn't as efficient: Last year, its operating margins were 13.9%, vs. Columbia's 15%.

But Quorum's unusual history may now give it a unique advantage. Unlike its chief rivals, Quorum began not as an acquirer but as a manager of hospitals, specifically not-for-profit hospitals. Consolidation over the last few years has left fewer acquisition opportunities among for-profit institutions, forcing hospital chains to shift their focus to nonprofits. That's a sector Quorum knows better than anybody—and handles with great diplomacy. "There's no magic formula for acquiring not-for-profit hospitals, but we approach them with a phenomenal amount of respect," says Quorum chief

utive James E. Dalton Jr.

Quorum was born in 1989 when Hos-
Corp. of America spun off its con-
management division, a profitable
slow-growth business. (Columbia ac-
ed the rest of HCA in 1994.) Today,
um manages 238 hospitals and acts
consultant to 173 others. Its clien-
spans 43 states and for the most
are private foundations, religious
ps, municipal agencies, or other tax-
nt entities. Although Quorum is
biggest in the business, the \$79 mil-
in management fees that it reaped
year amounted to only 6.4% of its
revenues. But the size of the fees
not reflect the business' rising val-
to Quorum as it seeks to grow
ugh acquisitions. Dalton, who joined
company in 1990 but knows it from
lays as an executive with HCA in the
s, calls the management business
strategic foundation."

Quorum's reputation and experience
it a leg up in vying to take over
for-profit hospitals. Take a look at
recent battle in Ohio, a state that
become a testing ground for the

latest phase of health-care consolidation because of an excess of not-for-profit hospitals. When Barberton Citizens Hospital, a 363-bed facility in blue-collar Barberton, outside Akron, first put itself on the block in late 1995, Quorum was closed out of the bidding when it showed up late.

But a local operator, Summa Health Systems, desperate to block an entrance into its market by Columbia, approached Quorum about a joint bid. Albert Gilbert, Summa's CEO, knew Quorum only by reputation but that was enough. "We'd heard good things," Gilbert says, "so we invited them to join us." Quorum and Summa enhanced their chances by enlisting a third partner: the Cleveland Clinic, the region's preeminent health-care facility. In June, 1996, Quorum and its minority partners signed a deal to acquire Barberton Citizens for \$85 million, about what Columbia had offered.

While Barberton's leaders were eager to forge closer ties to Summa and the Cleveland Clinic, Quorum's willingness to guarantee a full roster of medical services for at least 10 years weighed no less heavily in its favor. By contrast, Columbia "wasn't willing to guarantee even a day," according to Michael Bernatovicz, president and CEO of Barberton Citizens. Quorum was

savvy enough to work with the local community in other ways, backing a series of public meetings that culminated in a referendum. "The last thing we want to do is be part of a community that doesn't want us," Dalton says.

Compare that to Columbia. When Columbia tried to take over Massillon Community Hospital at around the same time, part of what stirred Strobel and other citizens of Massillon to action was the giant chain's secrecy. News of a proposed sale to Columbia took most Massillonians, including the mayor and the city council, by surprise. Once the news broke, Columbia refused to disclose the terms of its purchase or its plans. Hospital officials were no more forthcoming.

STALEMATE. The stonewalling didn't sit well with the townsfolk. "We argue like heck here over the renaming of a street, and now our community hospital is being sold, and we don't know the first thing about it," says John Frieg, city council president. The city council sued to block the sale, creating a stalemate that was broken this spring by Ohio Attorney General Betty Montgomery.

At Montgomery's urging, Massillon Community is now preparing to send out a request for proposals and expects a half-dozen offers, including a revised Columbia bid. "Columbia is probably at a disadvantage now because of the feelings of the people locally, and because of the attorney general," says Mervin F. Strine, president and CEO of Massillon Community. By most accounts, Quorum, which bought a second, smaller hospital in Massillon last year, has an edge. Richard L. Scott, CEO of Columbia, wouldn't comment on Massillon, but he acknowledges that dealing with small-town nonprofits requires a new ap-



At your age, with your high cholesterol, what's your risk of a first heart attack?

If you have high cholesterol, figure your risk of a first heart attack.

Fill in your points for each risk factor.

- ☐ **Age: Men**
0 pts. Less than 35 2 pts. 40 to 48 4 pts. 54+
1 pt. 35 to 39 3 pts. 49 to 53
- ☐ **Age: Women**
0 pts. Less than 42 2 pts. 45 to 54 4 pts. 74+
1 pt. 42 to 44 3 pts. 55 to 73
- ☐ **Family History:**
2 pts. My family has a history of heart disease or heart attacks before the age of 60
- ☐ **Inactive Lifestyle:**
1 pt. I rarely exercise or do anything physically demanding
- ☐ **Weight:**
1 pt. I'm more than 20 lbs. over my ideal weight
- ☐ **Smoking:**
1 pt. I'm a smoker
- ☐ **Diabetic:**
1 pt. Male Diabetic
2 pts. Female Diabetic

- ☐ **Total Cholesterol Level:**
0 pts. Less than 240 mg/dL
1 pt. 240 to 315 mg/dL
2 pts. More than 315 mg/dL
- ☐ **HDL Level (good cholesterol):**
0 pts. 39 to 59 mg/dL
1 pt. 30 to 38 mg/dL
2 pts. Under 30 mg/dL
-1 pt. Over 60 mg/dL
- ☐ **Blood Pressure:**
I don't take blood pressure medication; my blood pressure is:
(Use your top or higher blood pressure number)
0 pts. Less than 140 mmHg
1 pt. 140 to 170 mmHg
2 pts. Greater than 170 mmHg
(or)
1 pt. I am currently taking blood pressure medication

☐ **Total Points**

If you scored 4 points or more, you could be at above average risk of a first heart attack compared to the general adult population. The more points you score, the greater your risk.

If you have already had a heart attack or have heart disease, your heart attack risk is significantly higher. **Only your doctor can evaluate your risk and recommend treatment plans to reduce your risk.** If you don't know your cholesterol level or blood pressure, ask your doctor if your levels should be checked.

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American Heart
Association
Fighting Heart Disease
and Stroke



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Pravachol, in combination with diet, is proven to reduce the risk of a first heart attack, reduce the risk of death from heart disease, and reduce the need for surgery to clear blocked coronary

arteries (such as bypass or angioplasty) based on a landmark study including over 6,500 males with high cholesterol and no evidence of heart disease. Because PRAVACHOL is a prescription

drug, you should ask your doctor or healthcare professional if PRAVACHOL is right for you. Some mild side effects, such as slight rash or stomach upset, occur in about 2-4% of patients.

PRAVACHOL[®]

Proven to help prevent first heart attacks in people with high cholesterol.

PRAVACHOL is the only cholesterol-lowering drug of its kind proven to help prevent first heart attacks. And the fact is, up to 33% of people do not survive their first heart attack. Improving your diet and exercise is an important first step, but may not be enough. So ask

your doctor about PRAVACHOL. It reduces the risk of a first heart attack and the need for surgery to clear blocked coronary arteries. PRAVACHOL has been prescribed by doctors for millions of men and women worldwide. It could help you live a longer, healthier life.

Ask your doctor if PRAVACHOL is right for you. Or call 1-800-PREVENT for information on *first heart attack prevention* including a free brochure from the American Heart Association. All provided by Bristol-Myers Squibb.



**Proven to help prevent
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PRAVACHOL should not be taken by women who are pregnant or nursing, people who are allergic to any of its ingredients or by anyone with liver disease. Your doctor may perform simple

blood tests to check your liver function before and during treatment with PRAVACHOL. Muscle pain or weakness could be a sign of a rare but serious side effect and should be reported to your

doctor right away. Be sure your doctor knows about other medications you may be taking in order to avoid any possible serious drug interactions. Please see important information on the next page.

CONTRAINDICATIONS: Hypersensitivity to any component of this medication. Active liver disease or unexplained, persistent elevations in liver function tests (see **WARNINGS: Pregnancy and Lactation**). Atherosclerosis is a chronic process and discontinuation of lipid lowering drugs during pregnancy should have little impact on the outcome of long-term therapy of primary hypercholesterolemia. Cholesterol and other products of cholesterol biosynthesis are essential components for fetal development (including synthesis of steroids and cell membranes). Since HMG-CoA reductase inhibitors decrease cholesterol synthesis and possibly the synthesis of other biologically active substances derived from cholesterol, they may cause fetal harm when administered to pregnant women. Therefore, HMG-CoA reductase inhibitors are contraindicated during pregnancy and in nursing mothers. **Pravastatin should be administered to women of childbearing age only when such patients are highly unlikely to conceive and have been informed of the potential hazards.** If the patient becomes pregnant while taking this class of drug, therapy should be discontinued and the patient apprised of the potential hazard to the fetus.

WARNINGS: Liver Enzymes: HMG-CoA reductase inhibitors, like some other lipid-lowering therapies, have been associated with biochemical abnormalities of liver function. Increases of serum transaminase (ALT, AST) values to more than 3 times the upper limit of normal occurring on 2 or more (not necessarily sequential) occasions have been reported in 1.3% of patients treated with pravastatin in the US over an average period of 18 months. These abnormalities were not associated with cholestasis and did not appear to be related to treatment duration. In those patients in whom these abnormalities were believed to be related to pravastatin and who were discontinued from therapy, the transaminase levels usually fell slowly to pretreatment levels. These biochemical findings are usually asymptomatic although worldwide experience indicates that anorexia, weakness, and/or abdominal pain may also be present in rare patients. In the largest long-term placebo-controlled clinical trial with pravastatin (Pravastatin Primary Prevention Study), the overall incidence of AST and/or ALT elevations to greater than three times the upper limit of normal was 1.05% in the pravastatin group as compared to 0.75% in the placebo group. One (0.03%) pravastatin-treated patient and 2 (0.06%) placebo-treated patients were discontinued because of transaminase elevations. Of the patients with normal liver function at week 12, three of 2875 treated with pravastatin (0.10%) and one of the 2919 placebo patients (0.03%) had elevations of AST greater than three times the upper limit of normal on two consecutive measurements and/or discontinued due to elevations in transaminase levels during the 48 years (median treatment) of the study. **It is recommended that liver function tests be performed prior to and at 12 weeks following initiation of therapy or the elevation of dose.** Patients who develop increased transaminase levels or signs and symptoms of liver disease should be monitored with a second liver function evaluation to confirm the finding and be followed thereafter with frequent liver function tests until the abnormalities return to normal. Should an increase in AST or ALT of three times the upper limit of normal or greater persist, withdrawal of pravastatin therapy is recommended. Active liver disease or unexplained transaminase elevations are contraindications to the use of pravastatin (see **CONTRAINDICATIONS**). Caution should be exercised when pravastatin is administered to patients with a history of liver disease or heavy alcohol ingestion (see **CLINICAL PHARMACOLOGY: Pharmacokinetics/Metabolism**). Such patients should be closely monitored, started at the lower end of the recommended dosing range, and titrated to the desired therapeutic effect. **Skeletal Muscle:** Rare cases of rhabdomyolysis with acute renal failure secondary to myoglobinuria have been reported with pravastatin and other drugs in this class. Uncomplicated myalgia has also been reported in pravastatin-treated patients (see **ADVERSE REACTIONS**). Myopathy, defined as muscle aching or muscle weakness in association with increases in creatine phosphokinase (CPK) values to greater than 10 times the upper normal limit, was rare (< 0.1%) in pravastatin clinical trials. Myopathy should be considered in any patient with diffuse myalgias, muscle tenderness or weakness, and/or marked elevation of CPK. Patients should be advised to report promptly unexplained muscle pain, tenderness or weakness, particularly if accompanied by malaise or fever. **Pravastatin therapy should be discontinued if markedly elevated CPK levels occur or myopathy is diagnosed or suspected.** Pravastatin therapy should also be temporarily withheld in any patient experiencing an acute or serious condition predisposing to the development of renal failure secondary to rhabdomyolysis, e.g., sepsis; hypotension, major surgery; trauma; severe metabolic, endocrine, or electrolyte disorders; or uncontrolled epilepsy. The risk of myopathy during treatment with another HMG-CoA reductase inhibitor is increased with concurrent therapy with either erythromycin, cyclosporine, niacin, or fibrates. However, neither myopathy nor significant increases in CPK levels have been observed in three reports involving a total of 100 post-transplant patients (24 renal and 76 cardiac) treated for up to two years concurrently with pravastatin 10-40 mg and cyclosporine. Some of these patients also received other concomitant immunosuppressive therapies. In one single-dose study, pravastatin levels were found to be increased in cardiac transplant patients receiving cyclosporine. Further, in clinical trials involving small numbers of patients who were treated concurrently with pravastatin and niacin, there were no reports of myopathy. Also, myopathy was not reported in a trial of combination pravastatin (40 mg/day) and gemfibrozil (1200 mg/day), although 4 of 75 patients on the combination showed marked CPK elevations versus one of 73 patients receiving placebo. There was a trend toward more frequent CPK elevations and patient withdrawals due to musculoskeletal symptoms in the group receiving combined treatment as compared with the groups receiving placebo, gemfibrozil, or pravastatin monotherapy (see **PRECAUTIONS: Drug Interactions**). The use of fibrates alone may occasionally be associated with myopathy. The combined use of pravastatin and fibrates should be avoided unless the benefit of further alterations in lipid levels is likely to outweigh the increased risk of this drug combination.

PRECAUTIONS: General: Pravastatin may elevate creatinine phosphokinase and transaminase levels (see **ADVERSE REACTIONS**). This should be considered in the differential diagnosis of chest pain in a patient on therapy with pravastatin. **Homozygous Familial Hypercholesterolemia:** Pravastatin has not been evaluated in patients with rare homozygous familial hypercholesterolemia. In this group of patients, it has been reported that HMG-CoA reductase inhibitors are less effective because the patients lack functional LDL receptors. **Renal Insufficiency:** A single 20 mg oral dose of pravastatin was administered to 24 patients with varying degrees of renal impairment (as determined by creatinine clearance). No effect was observed on the pharmacokinetics of pravastatin or its 3 α -hydroxy isomeric metabolite (SQ 31,906). A small increase was seen in mean AUC values and half-life ($t_{1/2}$) for the inactive enantiomer, 1 α -hydroxylation metabolite (SQ 31,945). Given this small sample size, the dosage administered, and the degree of individual variability, patients with renal impairment who are receiving pravastatin should be closely monitored. **Information for Patients:** Patients should be advised to report promptly unexplained muscle pain, tenderness or weakness, particularly if accompanied by malaise or fever. **Drug Interactions: Immunosuppressive Drugs:** Gemfibrozil, Niacin (Nicotinic Acid), Erythromycin (see **WARNINGS: Skeletal Muscle**). **Antiglycine:** Since concomitant administration of pravastatin had no effect on the clearance of antiglycine, interactions with other drugs metabolized via the same hepatic cytochrome isozymes are not expected. **Cholestyramine/Colestipol:** Concomitant administration resulted in an approximately 40 to 50% decrease in the mean AUC of pravastatin. However, when pravastatin was administered 1 hour before or 4 hours after cholestyramine or 1 hour before colestipol and a standard meal, there was no clinically significant decrease in bioavailability or therapeutic effect (see **DOSE AND ADMINISTRATION: Concomitant Therapy**). **Warfarin:** In a study involving 10 healthy male subjects given pravastatin and warfarin concomitantly for 6 days, bioavailability parameters at steady state for pravastatin (parent compound) were not altered. Pravastatin did not alter the plasma protein-binding of warfarin. Concomitant dosing did increase the AUC and C_{max} of warfarin but did not produce any changes in its anticoagulant action ($t_{1/2}$, no increase was seen in mean prothrombin time after 6 days of concomitant therapy). However, bleeding and extreme prolongation of prothrombin time has been reported with another drug in this class. Patients receiving warfarin-type anticoagulants should have their prothrombin times closely monitored when pravastatin is initiated or the dosage of pravastatin is changed. **Cimetidine:** The AUC ($t_{1/2}$) for pravastatin when given with cimetidine was not significantly different from the AUC for pravastatin when given alone. A significant difference was observed between the AUC's for pravastatin when given with cimetidine compared to when administered with antacid. **Doxin:** In a crossover trial involving 18 healthy male subjects given pravastatin and doxin concurrently for 9 days, the bioavailability parameters of doxin were not affected. The AUC of pravastatin tended to increase, but the overall bioavailability of pravastatin plus its metabolites SQ 31,906 and SQ 31,945 was not altered. **Cyclosporine:** Some investigators have measured cyclosporine levels in patients on pravastatin, and to date, these results indicate no clinically meaningful elevations in cyclosporine levels. In one single-dose study, pravastatin levels were found to be increased in cardiac transplant patients receiving cyclosporine. **Gemfibrozil:** In a crossover study in 20 healthy male volunteers given concomitant single doses of pravastatin and gemfibrozil, there was a significant decrease in urinary excretion and protein binding of pravastatin. In addition, there was a significant increase in AUC, C_{max}, and T_{max} for the pravastatin metabolite SQ 31,906. Combination therapy with pravastatin and gemfibrozil is generally not recommended. In interaction studies with aspirin, antacids (1 hour prior to PRAVACHOL), cimetidine, nicotinic acid, or probucol, no statistically significant differences in bioavailability were seen when PRAVACHOL (pravastatin sodium) was administered. **Other Drugs:** During clinical trials, no noticeable drug interactions were reported when PRAVACHOL was added to diuretics, antihypertensives, digitalis, ACE inhibitors, calcium channel blockers, beta-blockers, or nitroglycerin. **Endocrine Function:** HMG-CoA reductase inhibitors interfere with cholesterol synthesis and lower circulating cholesterol levels and, as such, might theoretically blunt adrenal or gonadal steroid hormone production. Results of clinical trials with pravastatin in males and post-menopausal females were inconsistent with regard to possible effects of the drug on basal steroid hormone levels. In a study of 21 males, the mean testosterone response to human chorionic gonadotropin was significantly reduced ($p < 0.004$) after 16 weeks of treatment with 40 mg of pravastatin. However, the percentage of patients showing a $\geq 50\%$ rise in plasma testosterone after human chorionic gonadotropin stimulation did not change significantly after therapy in these patients. The effects of HMG-CoA reductase inhibitors on spermatogenesis and fertility have not been studied in adequate numbers of patients. The effects, if any, of pravastatin on the pituitary-gonadal axis in pre-menopausal females are unknown. Patients treated with pravastatin who display clinical evidence of endocrine dysfunction should be evaluated appropriately. Caution should also be exercised if an HMG-CoA reductase inhibitor or other agent used to lower cholesterol levels is administered to patients also receiving other drugs (e.g., corticosteroids, spironolactone, cimetidine) that may diminish the levels or activity of steroid hormones. **CNS Toxicity:** CNS vascular lesions, characterized by perivascular hemorrhage and edema and mononuclear cell infiltration of perivascular spaces, were seen in dogs treated with pravastatin at a dose of 25 mg/kg/day, a dose that produced a plasma drug level about 50 times higher than the mean drug level in humans taking 40 mg/day. Similar CNS vascular lesions have been observed with several other drugs in this class. A chemically similar drug in this class produced optic nerve degeneration (Wallenian degeneration of retinogeniculate fibers) in clinically normal dogs in a dose-dependent fashion starting at 60 mg/kg/day, a dose that produced mean plasma drug levels about 30 times higher than the mean drug level in humans taking the highest recommended dose (as measured by total enzyme inhibitory activity). This same drug also produced vestibulocochlear (Wallenian-like) degeneration and retinal ganglion cell chromatolysis in dogs treated for 14 weeks at 180 mg/kg/day, a dose which resulted in a mean plasma drug level similar to that seen with the 60 mg/kg/day dose. **Carcinogenesis, Mutagenesis,**

increased incidence of hepatocellular carcinomas in males at the highest dose ($p < 0.01$). Although rats were given up to 10 times the human dose (HD) on a mg/kg body weight basis, serum drug levels were only 6 to 10 times higher than those measured in humans given 40 mg pravastatin as measured by AUC. The oral administration of 10, 30, or 100 mg/kg (pr) plasma drug levels approximately 0.5 to 5.0 times the human drug levels at 40 mg of pravastatin to mice for 22 weeks resulted in a statistically significant increase in the incidence of malignant lymphomas in treated females when all three groups were pooled and compared to controls ($p < 0.05$). The incidence was not dose-related and male mice were not affected. A chemically similar drug in this class was administered to mice for 72 weeks at 25, 100, and 400 mg/kg body weight, resulting in mean serum drug levels approximately 3, 15, and 33 times higher than the mean human serum drug concentration (as total inhibitory activity) after a 40 mg oral dose. Liver carcinomas were significantly increased in high-dose female mid- and high-dose males, with a maximum incidence of 90 percent in males. The incidence of adenomas of the liver was significantly increased in mid- and high-dose females. Drug treatment also significantly increased the incidence of adenomas in mid- and high-dose males and females. Adenomas of the eye Harderian gland (a gland of the eye of rodent) were significantly higher in high-dose mice than in controls. No evidence of mutagenicity was observed *in vitro*, with or without liver metabolic activation, in the following studies: microbial mutagen tests, using mutant strains of *Salmonella typhimurium*, *Escherichia coli*, a forward mutation assay in L5178Y TK +/– mouse lymphoma cells, a chromosomal aberration test in human cells, and a gene conversion assay using *Saccharomyces cerevisiae*. In addition, there was no evidence of mutagenicity either a dominant lethal test in mice or a micronucleus test in mice. In a study in rats, with daily doses up to 500 mg pravastatin did not produce any adverse effects on fertility or general reproductive performance. However, in a study another HMG-CoA reductase inhibitor, there was decreased fertility in male rats treated for 34 weeks at 25 mg/kg body weight although this effect was not observed in a subsequent fertility study when this same dose was administered for 11 weeks. The entire cycle of spermatogenesis, including epididymal maturation. In rats treated with this same reductase inhibitor (mg/kg/day), seminiferous tubule degeneration (necrosis and loss of spermatogenic epithelium) was observed. Although not with pravastatin, two similar drugs in this class caused drug-related testicular atrophy, decreased spermatogenesis, spermatocytic degeneration, and giant cell formation in dogs. The clinical significance of these findings is unclear. **Pregnancy Category X.** See **CONTRAINDICATIONS**. Safety in pregnant women has not been established. Pravastatin is teratogenic in rats at doses up to 1000 mg/kg daily or in rabbits at doses of up to 50 mg/kg daily. These doses resulted in (rabbit) or 240x (rat) the human exposure based on surface area (mg/m²). However, in studies with another HMG reductase inhibitor, skeletal malformations were observed in rats and mice. There has been one report of severe con bony deformity, tracheo-esophageal fistula, and anal atresia (Vater association) in a baby born to a woman who took an HMG-CoA reductase inhibitor with dextroamphetamine sulfate during the first trimester of pregnancy. PRAVACHOL (pravastatin sodium) should be administered to women of child-bearing potential only when such patients are highly unlikely to conceive and have been informed of the potential hazards. If the woman becomes pregnant while taking PRAVACHOL (pravastatin sodium), it should be discontinued and the patient advised again as to the potential hazards to the fetus. **Nursing Mothers:** A small amount of pravastatin is excreted in human breast milk. Because of the potential for serious adverse reactions in infants, women taking PRAVACHOL should not nurse (see **CONTRAINDICATIONS**). **Pediatric Use:** Safety and effectiveness in individuals less than 18 years old have not been established. Hence, treatment in patients less than 18 years of age is not recommended at this time.

ADVERSE REACTIONS: Pravastatin is generally well tolerated, adverse reactions have usually been mild and transient. In month long placebo-controlled trials, 1.7% of pravastatin-treated patients and 1.2% of placebo-treated patients were discontinued from treatment because of adverse experiences attributed to study drug therapy, this difference was statistically significant. In long-term studies, the most common reasons for discontinuation were asymptomatic transaminase increases and mild, non-specific gastrointestinal complaints. During clinical trials the overall incidence of adverse events in the elderly was not different from the incidence observed in younger patients. **Adverse Clinical Events:** All adverse clinical events (regardless of attribution) reported in more than 2% of pravastatin-treated patients in the placebo-controlled trials are identified in the table below, also shown are the percentages of patients in whom these medical events were thought to be related or possibly related to the drug.

Body System/Event	All Events		Events Attributed to Study Drug	
	Pravastatin (N = 900)	Placebo (N = 411)	Pravastatin (N = 900)	Placebo (N = 411)
	%	%	%	%
Cardiovascular				
Cardiac Chest Pain	4.1	3.4	0.1	0.1
Dermatologic Rash	4.1	1.1	1.1	0.9
Gastrointestinal				
Abdominal Pain	7.3	7.1	2.9	3.4
Diarrhea	1.1	5.6	2.0	1.9
Abdominal Pain	1.1	5.1	2.0	3.9
Constipation	4.1	7.1	2.4	5.1
Flatulence	3.3	1.1	2.7	3.4
Heartburn	1.1	1.1	2.0	1.1
General				
Fatigue	3.8	3.4	1.1	1.1
Chest Pain	3.7	1.1	0.3	0.2
Influenza	2.4*	1.7	1.1	0.1
Musculoskeletal				
Localized Pain	10.0	4.1	1.4	1.4
Myalgia	1.1	1.1	0.6	0.0
Nervous System				
Headache	6.2	1.1	1.1	0.1
Dizziness	3.3	3.2	1.1	0.5
Renal/Gonitourinary				
Urinary Abnormality	2.4	2.9	1.1	1.1
Respiratory				
Common Cold	7.0	6.3	0.0	1.1
Rhinitis	1.1	1.1	1.1	0.0
Cough	1.1	1.1	1.1	0.0

*Statistically significantly different from placebo

In the Pravastatin Primary Prevention Study (West of Scotland Coronary Prevention Study) (see **CLINICAL PHARMACOLOGY: Clinical Studies**) involving 6595 patients treated with PRAVACHOL (pravastatin sodium) (N = 3302) or placebo (N = 3293), adverse event profile in the pravastatin group was comparable to that of the placebo group over the median 4.8 year study. The following effects have been reported with drugs in this class, not all the effects listed below have necessarily been associated with pravastatin therapy. **Skeletal myopathy, rhabdomyolysis, arthralgia, Neurological dysfunction of certain nerves (including alteration of taste, impairment of extra-ocular movement, facial paresis), tremor, vertigo, memory impairment, peripheral neuropathy, peripheral nerve palsy, anxiety, insomnia, depression, Hypersensitivity Reaction:** apparent hypersensitivity syndrome has been reported rarely which has included one or more of the following: fever, anaphylaxis, angioedema, lupus erythematosus-like syndrome, polymyalgia rheumatica, dermatomyositis, vasculitis, leukocytoclastic vasculitis, leukopenia, hemolytic anemia, positive ANA, ESR increase, eosinophilia, arthritis, arthralgia, myasthenia, photosensitivity, fever, chills, flushing, malaise, dyspnea, toxic epidermal necrolysis, erythema multiforme, etc. Stevens-Johnson syndrome, **Gastrointestinal:** pancreatitis, hepatitis, including chronic active hepatitis, cholestatic jaundice, fatty change in liver, and rarely, cirrhosis, fulminant hepatic necrosis, and hepatoma, anorexia, vomiting. **Skin:** acne, pruritus. A variety of skin changes (e.g., nodules, discoloration, dryness of skin/mucous membranes, changes to hair/nails) have been reported. **Reproductive:** gynecostoma, loss of libido, erectile dysfunction. Eye: progression of cataracts (less frequent with pravastatin). **Laboratory Abnormalities:** elevated transaminases, alkaline phosphatase, and bilirubin, thyroid function abnormalities. **Laboratory Test Abnormalities:** Increases in serum transaminase (ALT, AST) values and CPK have been observed (see **WARNINGS**). Transient asymptomatic eosinophilia has been reported. Eosinophil counts usually return to normal despite continued therapy. Anemia, thrombocytopenia, and leukopenia have been reported with HMG-CoA reductase inhibitors. **Concomitant Therapy:** Pravastatin has been administered concurrently with cholestyramine, colestipol, antacid, probucol and gemfibrozil. Preliminary data suggest that the addition of either probucol or gemfibrozil to therapy with pravastatin or pravastatin is not associated with greater reduction in LDL cholesterol than that achieved with lovastatin alone. No adverse reactions unique to the combination or in addition to those previously reported for either drug alone have been reported. Myopathy and rhabdomyolysis (with or without acute renal failure) have been reported when HMG-CoA reductase inhibitor was used in combination with immunosuppressive drugs, gemfibrozil, erythromycin, cyclosporine, or lowering doses of nicotinic acid. Concomitant therapy with HMG-CoA reductase inhibitors and these agents is generally not recommended (see **WARNINGS: Skeletal Muscle** and **PRECAUTIONS: Drug Interactions**).

OVERDOSE: To date, there are two reported cases of overdose with pravastatin, both of which were asymptomatic and not associated with clinical laboratory abnormalities. If an overdose occurs, it should be treated symptomatically and supportive therapy.

CAUTION: Federal (USA) law prohibits dispensing without prescription.

BOXING

'I CAN LIFT THE NAME OF BOXING'

After Holyfield-Tyson, the big draw may be De La Hoya

Where does boxing go after Holyfield-Tyson II, the event that has been billed as the biggest rematch in history? Most of the other heavyweights are past their prime or too obscure to make the splash required for a big pay-per-view payday. The answer may lie behind an angelic face gazing out from one of those milk moustache ads. It belongs to Oscar De La Hoya, the undefeated 147-pounder who has knocked out 21 of his 25



ONE-TWO PUNCH: Fierce, sexy

opponents and who is being sold, rock-star style, as "dangerously handsome."

Not only does the 24-year-old De La Hoya have a devastating one-two punch for marketers—fast fists and sex appeal—but he also is a Mexican American. That's important because boxing—and many advertisers—are actively courting Hispanics, the fastest-growing group in the U.S. "We have gone out of our way to target the Hispanic market," says Las Vegas boxing promoter Bob Arum of Top Rank Inc.

YOUNG BLOOD. In part, it's a matter of necessity. Although boxing got a boost from Mike Tyson's November loss to Evander Holyfield and the June 28 rematch—expected to be the largest pay-per-view event ever—both fighters are in their 30s. Now, with 50% of PPV's event revenues coming from fights featuring Tyson, cable networks Home Box Office Inc. and Showtime Networks Inc. and their pay-per-view arms are trying to create a buzz in the lower weight classes, where Hispanic fighters tend to be more prominent. "We and our competitors are trying to develop the talent of tomorrow," says Jay Larkin, Showtime Sports & Event Programming's senior vice-president.

Showtime's ads for Holyfield-Tyson II tell the tale of the videotape. Directed by Spike Lee, the dramatic black-and-

white spots feature the massive heavyweights exchanging blows to the sound of eerie New Age music. Flip the channel to Spanish-language Univision, and the stark imagery reappears—but this time, it's the undercard fighter, longtime Mexican lightweight champ Julio Cesar Chavez, doling out the punishment.

NEW FANS. The poster child for the new push is De La Hoya, a brutal competitor with a reputation for clean living.

"With my image, my personality, and my charisma," he says, "I can lift the name of boxing." Certainly, people are tuning in. De La Hoya's Apr. 12 fight against Pernell Whitaker drew some 865,000 subscribers and made \$36 million—the largest-grossing non-heavyweight fight in history. "He's one of only two or three men right now who carry the sport," says Seth G. Abraham, president and CEO of Time Warner Sports. And De La Hoya has attracted a whole new audience: HBO reports that some 20% of his viewers are women.

De La Hoya has also attracted companies that have rarely ventured near boxing, such as Colgate-Palmolive Co., which uses him in its Spanish-language commercials for Mennen Speed Stick, and Logo Athletic, which is wrapping up a seven-figure deal with the fighter.

De La Hoya's agent, Leigh Steinberg, thinks Oscar's good-guy reputation and dazzling smile give him the "ability to... appeal to a larger audience." Although De La Hoya now trails George Foreman—the only other current boxer to get significant endorsements—Steinberg says: "Within a year, we'll blow them away." De La Hoya himself K.O.'s the idea of being categorized. "I'm trying to break that barrier," he says. Usually, when Oscar De La Hoya tries to break things, he succeeds.

By Jennifer Reingold in New York

h. "Everybody in the industry is living more time making sure the unity—not just the hospital executives—knows who they are."

The differences between the two don't end there. While Columbia is known for insisting its acquired hospitals quickly meet stiff financial pressures, Quorum is more laid back. It doesn't tolerate inefficiencies, but it does give its new acquisitions time to meet standards. "It is a bit of a culture change in that we have new financial patterns," says Barberton Citizens' Hospital CEO, John J. Matovicz. "But we already do meet them, and we're being given the time to meet the others."

ISSIVE. Dalton has worked hard to turn Quorum a more profitable operation. Last year, he recruited Eugene C. Fleming from Columbia to be chief operating officer. Fleming, who was Columbia's eastern group president, recently collapsed Quorum's separate divisions for owned and managed hospitals into a single structure with five regional presidents. The idea was to create larger hospital groupings that would be more cost-efficient and better able to exploit marketing opportunities.

As the approach seems to be working, the nine months ended Mar. 31, 1997, reported a 27% increase in revenue and a 24% gain in pretax income. The acquisitions accounted for much of the growth. Quorum benefited from a rise in admissions at its existing hospitals—an impressive performance time of general industry stagnation. The extra business came from new contracts with managed-care providers and increased referrals from other Quorum-owned or managed hospitals. Insurers are starting to notice. At a 16%, Quorum's stock has returned a 20.2% so far this year, compared to 12.7% for the sector.

In spite of Columbia's woes, Dalton is savvy enough to believe the industry will simply slink away. Even as he was coming to shove in Massillon, Ohio, he signed a letter of intent to acquire three other Ohio hospitals. And Ohio is hardly the only rival Quorum faces these days. "A number of private-capital firms have started up, and now you have five or six bidders where there used to be two or three," says Nancy L. Weaver, an analyst with Bancroft & Goodrich Inc., an Arkansas investment firm.

For his part, Dalton says he will exploit Quorum's high standing in the not-for-profit world by launching a De La Hoya-style acquisition blitz. Instead, he is pursuing a Quorum-style blitz: plans to pick up the pace of acquisition from three or four hospitals a year to five or six.

Anthony Bianco in Massillon, Ohio

IN BONDS, THE JUNKIER THE BETTER

Investors are stampeding to high yield. But are they setting themselves up for a fall?

It's one of the supreme ironies of today's markets. Equity investors, usually thought of as risk-takers, keep pouring money into blue chips such as General Electric Co. and Coca-Cola Co. while giving short shrift to second- and third-tier stocks. Yet bond investors, generally thought to be risk-averse, are taking a dim view of blue-chip bonds, such as U.S. Treasuries. Instead, they are snapping up the debt issued by those second- and third-tier companies: junk bonds.

The junk or "high-yield" bond market is on a roll not seen since the 1980s, when Michael R. Milken ruled the market from Drexel Burnham Lambert Inc.'s Beverly Hills trading room. So far this year, new issues top \$48 billion, and there's little doubt that 1997 will set a record. Investors, too, are rushing into high-yield mutual funds at breakneck speed. Sure, as long as the economy stays robust, the junk market should thrive as companies meet their debt service (page 30). But should economic growth slow sharply, many junk issuers may find it hard to make good to bondholders. "For three percentage points over Treasuries, is it worth the risk?" questions money manager Joel Unger of New York-based Stralem & Co.

Many folks think it is. For beleaguered fixed-income investors, junk has been one of the few places they could make money. "Everyone who's bought into the market for the last few years has outperformed all but emerging-markets debt," says Bennett J. Goodman, a managing director at Donaldson, Lufkin & Jenrette Inc., the No. 1 junk underwriter. "And you don't have as much volatility as you have in emerging markets." Kingman D. Penniman, whose firm, KDP Investment Advisors Inc., specializes in junk-bond research, suspects equity investors are buying high-yield as a hedge. "They figure high-yield bonds

may not get hit as hard if the market takes a fall."

Junk bonds look every bit as pricey as the Dow Jones industrials. The Merrill Lynch High-Yield Master Index of some 800 issues hit a new high of 451 on June 23—the day the Dow took a 192-point dive. But the real measure of this market is not price but the difference in yields between that index and a 10-year Treasury bond. On June 23, that difference was a mere 2.75 percentage points, up from 2.61, the low in the spread—and the high-water mark for the junk-bond market. That puts the yield on the average junk bond at 9.17%. In late 1990, with the economy in recession and junk bonds suffering through a severe bear market, that spread was over 9 percentage points and the average yield hit 17%.

RELAXED STANDARDS. Many analysts believe that junk bonds are a buy despite the niggardly premium over Treasuries. "It's not too narrow a spread considering that the economy is strong, there's plenty of liquidity, and default rates are at an all-time low," says Martin S. Fridson, global high-yield strategist at Merrill Lynch & Co. "The problem comes when those conditions change."

No one knows when that will happen, but there's no doubt the high-yield market is already sowing the seeds of

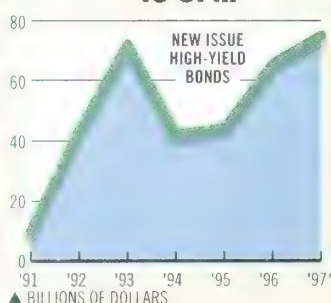
its next downturn. In reaching for yield, investors are relaxing credit standards in ways they may come to regret. James Parrish, a managing director at Moody's Investors Service, says 27 issues have come to market this year with Caa ratings—which is a near-fault rating—the same number as of last year. "When you count the rated bonds that will later get rated Caa or lower, that figure is probably going to be a lot higher."

Companies, many of them little known and inexperienced, are tripping over themselves to bring new bonds to market. Increasingly, they're taking advantage of Securities & Exchange Commission Rule 144A as a shortcut through the registration and disclosure maze if the deal is sold only to institutional investors. About two-thirds of new issuance is in 144A deals.

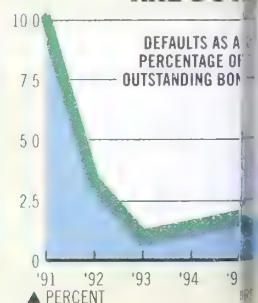
Companies are benefiting from strong investor demand, which is keeping interest rates low. Net cash inflows to high-yield bond funds are running at an annualized rate of \$16 billion, a big sum considering that the entire high-yield mutual-fund market is only \$1 billion, notes Robert Adler of AMG Services, which tracks cash flows in mutual funds. Junk-bond funds are only sort of bond mutual fund that have been taking in any new cash over

Junk
Bonds
Are
Flying
High

ISSUANCE IS UP...



...AND DEFAULTS ARE DOWN





them to trade for a quick profit without regard to quality.

And some managers complain, too, that in the quest for yield, investors ignore terms that favor issuers. D. Jerry Paul, portfolio manager of the Invesco High-Yield Fund, gripes about "clawback" provisions found in bonds issued by private companies. The clawback says if a company goes public within a certain time, usually three to five years, it can use the proceeds to call a certain percentage of the bonds. What's wrong with that? "An IPO is positive news, which should send the bond price higher," he says. "But with clawbacks, bond investors don't get the benefit of that." The clawback is "clearly advantageous to the company," says DLJ's Goodman. But he says buyers are willing to

Rushing to meet strong investor demand, companies—many of them little-known and inexperienced—are tripping over themselves to bring new bonds to market

three years. And by far, junk bonds are the principal method individual investors use to enter this market.

Pension funds are also turning to junk. Two large New York City pension funds that together have nearly \$1 billion in assets recently boosted their high-yield bond investments from 10% to 15% of assets, and trustees of a third fund recently voted to follow suit. "We call it an 'enhanced yield,'" says Steven L. Nesbitt, senior vice-president of Wilshire & Associates Inc., a bond-fund consulting firm. Over a 10-year horizon, says Nesbitt, high-yield funds can add about 2 percentage points per year over investment-grade bonds. Even blue-chip-grade investors are competing with traditional high-yield in-

vestors for junk bonds by investing in collateralized bond obligations (CBOs). In effect, a CBO is a closed-end bond fund for institutional investors. It carves up the cash generated by a portfolio of junk bonds and issues securities backed by that cash. By overcollateralizing the securities, the CBOs are able to obtain investment-grade ratings.

DANGEROUS MOMENTUM. Portfolio managers of high-yield bond funds bemoan the ever-shrinking spreads and deteriorating quality of the bonds. But they buy bonds nonetheless because that's what their investors expect them to do. "We've been saying for a long time that

spreads are too tight, but you can't

fight the flows," says Harry Resis, portfolio manager of the Kemper High-Yield Fund. "The key to this market is not to get lazy about your [credit] research." Resis says there's so much momentum—new bonds trade at a premium in the aftermarket—that many players buy

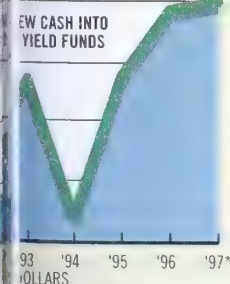
go along if the yields are high enough. Perhaps more troubling, say some, is the growing number of speculative offerings in the telecommunications and media industries, which account for about 30% of the high-yield market. Companies such as Globalstar and Iridium Inc. have issued or plan to issue bonds to fund low-earth-orbit satellites (LEOS) for wireless phone service—which competes with cellular and personal communications services (PCS), also the source of much high-yield debt.

"There's a lot of companies taking on debt to invest in technologies and systems yet to be proven or, in the case of LEOS, to serve markets that never existed before," says Richard Sideman, a telecommunications analyst at Standard & Poor's Corp. Adds KDP analyst Eric K. Tutterow: "It's a leap of faith that many of these companies will be able to cover this debt."

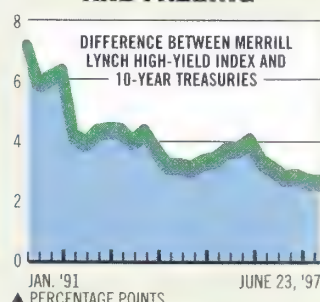
Of course, faith is the hallmark of a bull market, be it stocks or bonds. But if investors are willing to put money into the sorts of companies that issue junk bonds these days, they might as well buy the stocks. That way, the payoff has the potential to be a lot higher than the interest rate on a high-yield bond.

By Jeffrey M. Laderman
in New York

INVESTOR DEMAND IS STRONG...



...SO YIELD SPREADS ARE FALLING



SOURCE: INVESTMENT COMPANY INSTITUTE; AMG DATA SERVICES; MERRILL LYNCH, PIERCE, FENNER & SMITH

SCANDALS

A BIG STINK SPEEDS UP THE BIG BANG

Dirty deals let Hashimoto hurry financial deregulation

Even for the scandal-jaded Japanese, this was too much. Since March, tales of illicit payoffs to a gangster by Nomura Securities Co. and Dai-Ichi Kangyo Bank Ltd. have mesmerized the nation. Some 14 executives from both companies have been arrested, and on June 19, former Nomura President Hideo Sakamaki was indicted on criminal charges for allegedly paying hush money to reputed racketeer Ryuichi Koike, who has been charged with illegally receiving profits from the broker. Both men are behind bars, and neither has entered a plea or responded to requests for comment.

The crackdown is a rarity in a land where a deep bow and ceremonial resignation usually suffice for corporate wrongdoers. But with Tokyo prosecutors intent on widening their probe of mob ties in the financial industry, the summer will probably bring even more unsavory headlines. That would be bad news for Japanese brokers and bankers, already viewed by ordinary citizens as an overpaid, ethically challenged bunch. But the mess is giving Prime Minister Ryutaro Hashimoto the political cover he needs to speed up his plan to bring Tokyo's laggard financial markets up to global standards by 2001.

MORE PAIN. The program will mean pain and more foreign competition for local players already beset by an unprecedented banking crisis and stagnant stock market. Such big international competitors as Merrill Lynch, Fidelity Investments, Citibank, and Britain's Mercury Asset Management Group, are already getting ready to grab new business from Hashimoto's plan, dubbed "Big Bang" after former British Prime Minister Margaret Thatcher's program deregulating the City of London.

Hashimoto has little choice but to force competition and reforms on Japan's



Merrill Lynch and Fidelity are among the players hungrily eyeing Japan's long-stifled mutual funds market

inefficient financial services companies. To finance the outlays needed to care for a rapidly aging population, the country needs to obtain better returns from its nearly \$10 trillion in household savings. What's more, Japan's status as Asia's financial center has been undercut as local institutional investors have bypassed Tokyo for London, where commissions run 40% less than at home.

Japan's markets have also been hurt by a corporate and regulatory culture that has long tolerated white collar corruption and the pervasive presence of *sokaiya*, gangsters who specialize in ex-

torting money via shady investment deals or in exchange for not disrupting annual meetings. Only six years ago, Nomura was the center of a separate scandal involving underworld figures. Yet it suffered few sanctions. This time around, Hashimoto shows no sign of wanting to cut anyone any slack. A Ministry of Finance official insists Hashimoto is willing to "apply the law vigorously to whatever crimes" surfaced during the current probe. Perhaps that

because Hashimoto was forced to resign as Finance Minister following the last Nomura scandal. Since then, he has become more attuned to public sentiment.

BAN EASED. That much was clear on June 13, when the Ministry of Finance released a set of reforms moving up the timetable for introduction of new products. Such things are common in the West but have been banned at home. Although Japan has allowed trading in stock-index futures for years, in July, the MOF will for the first time permit trading of options on the big companies including Sony Corp. and Toyota Motor Corp. The MOF also plans to ease restrictions on bank accounts overseas, and liberalize rules limiting foreign exchange trading.

Despite screams from a capital-populated industry, commissions on stock trades are expected to be deregulated by 1999. Japan will abolish its long separation

between commercial, trust, and long-term credit banks, which lend to corporate clients. And the MOF will permit commercial and long-term lenders to vie with banks and life insurers for a piece of Japan's \$2 trillion pension fund market.

International money managers are hungrily eyeing a potentially huge market that has fallen in mutual funds. With the Tokyo stock market trading water since the bull run, Japanese investors have seen away only \$400 billion in mutual funds. Yet local brokers have continued to lure investors with high management fees and scant disclosure. That might change as more players get into the game. Fidelity has already attracted \$400 million for a European small-cap stock fund launched in 1995, and has also brought out a fund investing in dollar-denominated junk bonds. Merrill Lynch and Morgan Stanley Dean Witter are already jumping into the fray. Competition is coming. The locals have only themselves—and regulators—to blame.

By Brian Bremner in Tokyo



WHAT A DUMP

Locals say the county's landfill sell-off is rigged in favor of big out-of-town bidders

on an ill-conceived recycling plant. And the county and local cities have been engaged in endless litigation over everything from skyrocketing hauling fees to

landscaping old trash dumps. Now, the county needs to move quickly to sell off the landfills to pay down debt incurred from the recycling plant.

Not so fast, says McDade, one of a small army of local lobbyists and lawyers who are rallying behind San Diego Regional Disposal, a unit of St. Joseph (Mo.)'s Herzog Contracting, which was eliminated from an initial round of bidding. Herzog has strong links to the county: It handled county landfill operations from 1982 to 1995 and built a popular trolley line.

BEWILDERED. In letters from Herzog lawyers to Morgan and the county, and now in the lawsuit, Herzog points out that Morgan is one of several lenders in a \$1.6 billion credit line to USA Waste and has a 6.3% position in Allied Waste, making Morgan the largest holder of Allied's stock. "It's a blatant conflict of interest," complains Alan Landes, Herzog's Western regional manager. Herzog and its friends have even persuaded California Attorney General Daniel E. Lungren to investigate the bidding.

This has left Morgan officials in a bewildered state bordering on rage. "There's no conflict of interest under California law, and the bidding process has been consistently fair and open," says Michael George, a Morgan managing director. "If they think we are going to turn tail and run, they've got another thing coming." Privately, Morgan officials say they are astonished at how little some San Diego officials understand about how banking works. Morgan points out that it has no beneficial interest in the waste companies: Its piece of the loan to USA Waste is a mere \$75 million, and the Allied Waste stock is simply held in trust in various asset-management funds.

Independent securities experts say Morgan's involvement does raise a few red flags, although that shouldn't result in a deal breaker. "All this certainly has the appearance of impropriety, but it won't taint the process," says Alan R. Bromberg, a professor of securities law at Southern Methodist University in Dallas. Morgan's George insists there is "no impropriety here." Still, the proud folks from the House of Morgan are learning the hard way that local San Diego politics and garbage can be a very messy combination.

By Eric Schine in Los Angeles

KING

CKING MUD ON MORGAN'S WHITE SHOES

Diego critics charge the bank with conflict of interest

at white-shoe paragon of Wall Street firms, J. P. Morgan & Co. has one it all when it comes to commodifications—such as a pending billion nuclear fuel deal for the U.S. government. So when the investment bank spied a job shepherding the privatization of San Diego's \$200 million landfill trash transfer system, it saw an easy way to earn a little pocket change. It hasn't worked out that way. Just as after signing on as San Diego's financial adviser on the matter, it finds itself mired in a morass of local infighting. And the mud-slinging is getting uncomfortably close to Morgan's so-far-unsullied shoes. On June 25, a local bidder for the contract was sued against San Diego, charging the county with violating state laws that prohibit conflicts of interest. Criticizing Morgan is double dipping: collecting a commission from the county while having financial ties to two of the finalists—Allied Waste Industries of Mesa, Ariz., and USA Waste Services Inc. in Dallas. Final bids were due on June 24.

ALLEGATION. Morgan is not named as a defendant in the suit. But everyone from county politicians to the local press is arguing that the county and Morgan are rigging a privatization scheme in favor of big out-of-town bidders. "In

my 20 years in public service, I've never seen such a violation of due process," says J. Michael McDade, chairman of the San Diego Unified Port District.

Trash, as Morgan is painfully learning, is a long-festering sore in San Diego politics. The county nearly went bankrupt in 1995, after blowing \$139 million

MESSY BUSINESS

DECEMBER, 1996 San Diego County votes to put four landfills on the block for at least \$100 million.

FEBRUARY, 1997 The county hires J. P. Morgan as its financial adviser on the sale.

APRIL The county gets preliminary bids from top trash haulers, including USA Waste. J.P. Morgan is part of a bank group making a \$1.6 billion credit line to USA Waste.

JUNE San Diego Regional Disposal, a hauler eliminated from the competition, claims Morgan has a conflict of interest. The county and Morgan deny any conflict. Even so, State Attorney General Dan Lungren is looking into the affair. Final bids submitted on June 24.

DATA BUSINESS WEEK

By Gary Weiss

CLEARING FIRM, CLEAR THYSELF

He is a high official of a major brokerage that handles trades for smaller firms around the country. Small brokerages can't afford their own back offices, so they turn to this man's firm and other leading Wall Street firms—notably Bear Stearns and the Pershing division of Donaldson, Lufkin & Jenrette. "Correspondent clearing" is a humdrum, if lucrative, corner of Wall Street. But there is nothing at all routine about this man's job. He keeps his firm from working with brokers who manipulate stocks and rip off customers.

This exec, who insists on anonymity, has done his job well. He keeps voluminous files on stock promoters and rogue brokers, and tracks them from firm to firm—to keep away from them. So you won't read about his firm in the papers. But other big clearing firms are not so fortunate. The role of Bear Stearns, in particular, as clearing firm for A.R. Baron, Stratton Oakmont, and other firms with troubled regulatory histories has alarmed regulators and led to an examination of the rules governing clearing firms, which are not liable for the actions of firms clearing through them. "The Securities & Exchange Commission has expressed concern, and so have the state regulators," notes Salvatore Pallante, senior vice-president for member firm regulation at the New York Stock Exchange. Bear Stearns maintains that it has fully abided by the law and is working with regulators evaluating the clearing business.

NO COMFORT. The relationship between large Wall Street firms and small, sometimes shady ones is symbiotic. For large brokerages, the clearing business is a cash cow. And part of what they are selling to the smallest firms is prestige. Regulators note that cold-callers from small-stock firms often cite their links with prestigious clearing firms as a selling point in pushing stocks on the public. Bear Stearns General

Counsel Mark I. Lehman asserts that his firm would act swiftly to stop "improper use" of Bear's name. He acknowledges, however, that a relationship with Bear Stearns, by dint of its repute and financial standing, "is one of the ways firms derive comfort for their customers."

In fact, the customers have no



Large brokerage houses that don't screen the records of smaller client firms risk regulatory intervention

reason to feel comfort. Although clearing firms know intimately their client firms' trading patterns, as well as the sometimes excessive markups and commissions charged to the public, clearing firms have no legal obligation to pass on such information to the regulators. "I think they know perfectly well the caliber of firm they are dealing with," says Mark Griffin, president of the North American Securities Administrators Assn.

What's the solution? The clearing firms, not surprisingly, oppose any move to hold them liable for the actions of their clients. But sharing information with regulators might be more palatable. Lehman says regulators might want to require clearing

firms to report improper trading, plus excess commissions and markups—they remain liability-free.

Sharing information would help—but it isn't enough. Clearing firms must be goaded into more vigorous self-policing. They must cease lending their names to unsavory firms. How do smart firms do that? Pallante notes that many clearing firms demand to see the disciplinary and employment records of both principals and brokers of small firms before taking them on as clients. Otherwise, "you're asking for trouble," says Pallante. Checking managers alone is clearly not enough. "These brokers tend to all come from the same firms, and if I see that they are I won't take their firms on as clients," says the publicity-shy clearing firm exec.

NO DATA. By contrast, Bear Stearns has checked the disciplinary and employment records of small-firm principals—but has not checked brokers' records. Why not? Until March, Lehman says, the firm was legally barred from getting such info from the computer database of the National Association of Securities Dealers. But Pallante says other firms simply get broker info directly from pro-

Large brokerage houses that don't screen the records of smaller client firms risk regulatory intervention

spective clients—which Bear has never done. Lehman, after first telling *BUSINESS WEEK* that Bear never gets broker data from the NASD database, later withdrew the remark. "I am not sure we are accessing such information," he says.

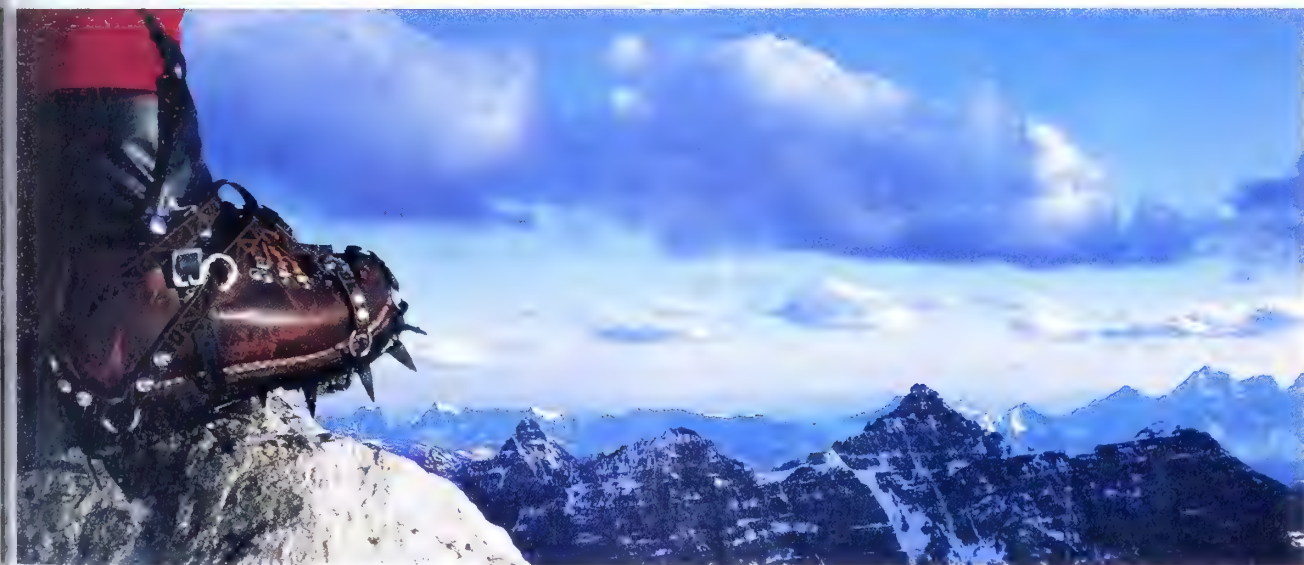
Such a lack of curiosity is legal, but shortsighted. If clearing firms continue to knowingly work with rotten brokers, regulators should expose them to liability for the actions of their clients. If they insist on lying down with Wall Street's dogs, they should not be protected from getting up with fleas.

Senior Writer Weiss covers Wall Street.

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BY GENE G. MARCIAL

SHOPPING MERCANTILE—AGAIN

Last year, Mercantile Stores (MST) glowed red-hot in the rumor mills: Buyout talk drove the stock from 45 to 64 in three months. No deal came through, and it sagged to the low 50s by June. Now Mercantile, with 102 department stores in 50 states, is back on the screens of buyout pros, who reckon at least two suitors are set on acquiring the company—at a higher price.

One New York banker says Federated Department Stores has put an informal \$75-a-share bid on the table. The stock is trading at 56. But management rejected the offer, saying the company, which one analyst calls a “high-quality gem,” is worth more.

He is sure Federated will come back with a sweetened offer, possibly \$80 to \$90 a share, because another interested party, May Department Stores, may beat it to the punch. May has yet to throw in a bid, he adds.

A New York investment manager says the directors—led by the Milliken family, which controls 40% of Mercantile—think the shares are worth \$100. The company, with sales of \$3.03 billion in the year ended Jan. 31, 1997, is expected to produce sales of \$3.3 billion in fiscal 1998.

Two factors argue that a friendly deal could indeed be in the works: Roger Milliken, a board member and head of the family—who long opposed any sale—is in his mid-70s. Some say he would now consider selling “at the right price.” If true, then the two other Millikens on the board—Gerrish, a brother of Roger, and Minot, a cousin—will probably go along.

The other reason for optimism about a buyout: Mercantile, whose balance sheet is healthy with a strong cash flow, has not been a spectacular performer—with core earnings growth of just 8% to 10%. Profits in 1997 slipped to \$3.30 a

share, down from \$3.35 a year before. In 1998, analysts expect \$3.78. “In the hands of more aggressive management, Mercantile could be propelled to improve its lackluster performance,” argues one analyst. Federated or May would benefit, he says, from Mercantile’s reach in the South and Midwest.

Analyst Karen Sack of Standard & Poor’s says Mercantile has talked mergers for years. It terminated talks with an unidentified buyer in November, 1994. Although Sack thinks the stock is fairly valued, she recommends it because she says a merger “is still a possibility.” Mercantile didn’t return calls and the Millikens couldn’t be reached for comment. Federated and May declined comment.

MORE PHONE FUN FROM QUINTEL

With no Wall Street following to speak of, Quintel Entertainment (QTEL), a little-known provider of automatic phone answering and telephone amusements—horoscopes, tarot-card readings, and live psychic consultations—has nearly doubled this year, to 15 a share. The reason is simple: Sales are on a tear, and earnings climbed from 51¢ a share in 1995 to 76¢ last year—and are expected to hit \$1.17 this year. That’s not all. Soon, “the company is expected to sign a blockbuster deal with HFS, a global franchiser of hotels and other services,” says a hedge-fund manager who has bought shares. “This deal will be a home run for Quintel, because it will be able to tap into the HFS database of 50 million customers,” he asserts, to market its phone services.

Quintel has its own database of 30 million customers. Quintel signed a marketing pact in 1996 with AT&T, whereby AT&T can offer Quintel services to win back customers who have switched to other phone companies. This AT&T link has upped sales in a big way. AT&T pays Quintel \$60 to \$70 for every customer it brings back.

With the HFS connection, Quintel database balloons, which means it can help AT&T win even more subscribers. And more customers will let Quintel and HFS tap into other markets.

One money manager, who figures Quintel is worth 25 a share, says earnings estimates are very conservative. Quintel CEO Jeffrey Schwartz says its current rate, revenues could be \$170 million this year, with cash flow of \$3 million to \$4 million a month.

SET TO SPAR IN NONLATEX GLOVES

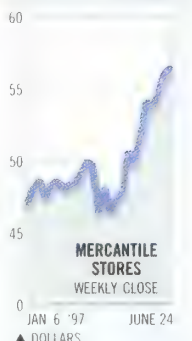
Since Maxxim Medical (MAM) acquired another company last year in a hostile takeover, CEO Ken Davidson makes no bones about his next goal: He will work on boosting the price of Maxxim stock, which dived 12 a share on the news, down from earlier last year. Apparently it is enough, he says, to post record sales and earnings. Maxxim is the largest U.S. maker of nonlatex medical gloves and clinical-procedure trays.

First thing Davidson did was commit senior managers to buy 400,000 shares, or 5%, of Maxxim stock, at apiece, or \$5.2 million, financed by the company through personal loans. It shows confidence, notes Davidson. The stock has since edged up to 15.

Also on his agenda: increasing production capacity for nonlatex gloves. Press reports about the dangers of latex gloves and lawsuits by people allergic to them have sparked demand. Maxxim Medical, which has 60% of the market, makes 6.8 million nonlatex gloves a day—and sells as many as it can turn out. As a result, Maxxim has raised the price of its powder-free SensiCare gloves.

“Gloves will make Maxxim a growth-stock play,” says Gregg Summerville, chief investment officer at Kirt Marbach in Columbus, Ind. He figures Maxxim will earn \$1.30 a share in the year ending Oct. 31, 1997, or \$1.70 in 1998. In 12 months, he expects the stock doubling, to 30.

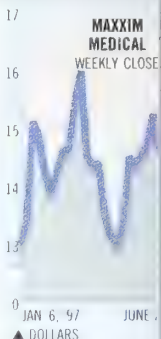
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AN ECONOMY ON STEROIDS?

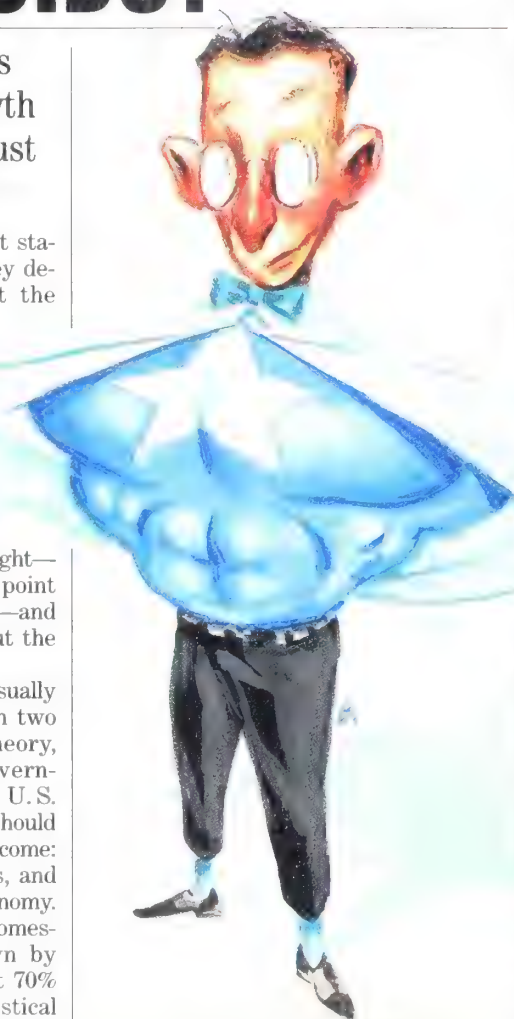
New Commerce numbers may show that U.S. growth has been even more robust than previously thought

Most revisions of government statistics get the attention they deserve: next to none. But the Commerce

Dept.'s new look at the U.S. economy could send a tremor through the markets. These new calculations, due on July 31, may show that America's already healthy growth has been stronger than previously thought—adding almost a full percentage point to growth for the last two years—and help clear up some mysteries about the economy's recent performance.

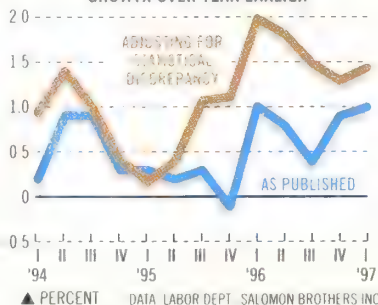
The key to the increase: an unusually large—and growing—gap between two measures of the economy. In theory, gross domestic product, the government's main yardstick for tracking U.S. production of goods and services, should be equal to U.S. gross domestic income: the sum of wages, salaries, profits, and other income generated by the economy.

But since early in 1993, gross domestic income has apparently grown by \$178 billion more than GDP. About 70% of this gap, known as the "statistical discrepancy," has accumulated over the past two years. Measured by income, the economy has posted a sizzling 3.7% growth rate, after inflation, during that period, compared to 2.9% growth in GDP. **"90 MPH."** These revisions will try to reconcile the two sets of numbers. If they boost the official GDP closer to the income data, "the record will show that the economy has been driving at 90 mph without any damage to the engine," declares Everett M. Ehrlich, president of economic consultants ESC Co. and until lately the Commerce Dept.'s top economic official. "The economy is capable of much faster growth without any feedback in inflation."



A DIFFERENT VIEW OF PRODUCTIVITY

NONFARM BUSINESS PRODUCTIVITY GROWTH OVER YEAR EARLIER



Which figures are more likely to be correct? Government analysts still believe that the income data are less so than the figures used to calculate GDP. "We continue to feel more confident about the product data," says Robert P. Parker, chief statistician at Commerce's Bureau of Economic Analysis. For example, government accountants don't get detailed income figures from tax returns until three years after the returns are filed. That lag can lead to statistical misunderstandings, since capital gains from the stock market are taxed as income—but they're supposed to be counted as increases in wealth, not income, in the national economic accounts. If some capital gains are miscounted in the preliminary tax data, they could inflate the income numbers. Bottom line: When the revisions are done, "GDP might go up, or income might come down," the BEA's Parker says.

But many economists are betting that GDP will be revised up.

Treasury Dept. analysts say the capital gains tax account for the recent surge in tax revenues, including the \$45 billion-a-year windfall that helps seal Washington's balanced-budget deal.

Those revenue gains are so large that "even the gross domestic income numbers may be too low," says Salomon Brothers Inc. economist David Hensley.

GONE AWOL. Upward revision of GDP would help solve several mysteries about the current expansion. For one thing, revisions could capture the productivity growth that has apparently gone AWOL during the expansion. The official productivity statistics, which are based on the GDP figures, show a meager annual nonfarm business productivity growth of only about 1% over the past two years. At that rate, rising wages and other labor costs should be squeezing profits—but Corporate America continues to report strong earnings increases.

Replacing the GDP growth rate with the income figures, though, boosts productivity growth to a respectable 1.5% since early 1995 (chart). Higher productivity can offset labor cost hikes—although still leave plenty of room for profits to grow. "Every measure of productivity suggests that GDP growth has to be revised up," says Gordon Richards, chief economist of the National Association of Manufacturers.

That sits well with Federal Reserve Chairman Alan Greenspan. He has long

d that official measures aren't cap-
all the productivity created by
rate restructuring and heavy in-
ent in new technologies. A sharp
d revision in growth would alarm
Fed officials, who fear that faster
h will lead to higher inflation.
span would argue, however, that
growth matched by higher pro-
pity poses no inflationary risk.

e revisions could also help explain
issing "wealth effect." Economy
ers, including the Federal Re-
have been puzzled because the
market boom, which has added
trillion to household wealth since
d of 1994, has apparently not led
her levels of consumer spending.
goes against past experience,
typically showed a significant
effect from soaring stock values
sumers spend some of their gains.

RIDDLES. But if there is an up-
revision to growth, much of the
would show up as an increase in
mer spending, suggesting that
has been a wealth effect. By Sa-
's calculations, substituting the
income figures raises consump-
y some \$110 billion. That's close to
wealth-effect models would pre-
om the stock market boom, since
ch indicates that each \$100 in-
in household net worth should
consumption spending by \$3. The
side: The extra consumption wipes
ported gains in the household sav-
ate.

the income figures don't just
mysteries: They create them, too.
ome is higher than output, the
my must be producing something
not being counted. But what?
of the extra income is coming
small businesses, suggesting that
tech startups and Internet com-
are creating shadow output," ac-
g to economist Ehrlich. "No way,"
er, is there "\$90 billion in com-
on the Internet," says a Clinton
istration economist. Another
exion: Financial services, which have
generating enormous profits, are
poorly counted in GDP. And output
health-care industry, where both
and employment are growing, is
counted, says John D. Hancock of
nal Financial Associates Inc.

en July's revisions won't stamp
Closed" on these puzzles. Given
ata lags and the need to upgrade
ment statistics, it may be years
e economists fully understand the
at business cycle. But this first cut
ancing the books should help make
sense of the numbers—and put
en brighter shine on the long-run-
expansion of the '90s.

by Mike McNamee in Washington



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CFCs

THE BLACK MARKET VS. THE OZONE

Despite global limits on CFC production, the traffic is brisk

Ten years ago, the world's nations signed a historic agreement to phase out chlorofluorocarbons (CFCs), chemicals used as coolants in refrigerators and air conditioners. The global cooperation was a response to evidence that CFCs had been eating a hole in the earth's protective ozone layer for decades. Industrial nations agreed under the Montreal Protocol to halt virtually all CFC production by 1996, with the developing nations given until 2010.

On the surface, the agreement has worked. Global production of CFCs, such as DuPont Co.'s popular Freon brand, dropped from 800,000 metric tons in 1987 to 156,000 last year. The world's chemical

companies, working with car- and appliance makers, spent millions of dollars to produce replacement coolants.

Still, if you own a car built before 1994 and you've replaced the coolant this summer, there's a good chance you are using illegal CFCs. The U.S. prohibits making or importing CFCs but doesn't ban the sale or use of chemicals made before the 1996 ban. That loophole was to allow the 130 million older cars using CFCs to be serviced. But the loophole also allows a thriving black market.

CFCs from factories in China, India, Mexico, and Russia—countries still allowed to make the chemical for domestic use—are wending their way to Europe,

the U.S., and Canada. The smugglers pass them off to repair shops as recycled CFCs—which are still legal—or claim they are part of grandfathered stockpiles. Drivers of older cars aren't likely to ask questions. It can cost as much as \$1,200 to retrofit a car's air-conditioning system for a CFC alternative. Recharging with CFC costs about \$8.

DEADLY RAYS. The price differential creates a great market for smugglers who brought an estimated \$500 million worth of the chemicals into the U.S. last year, according to the U.S. Customs Service. Worldwide, the U.N. estimates that some 30,000 metric tons of CFCs were smuggled into industrial countries in 1996, one-fifth of the total production. The U.S. Justice Department estimates that the CFC-smuggling racket is larger in value than the trade in illegal guns. It may also be more damaging. Ozone, a natural atmospheric gas, protects the earth from the sun's deadly ultraviolet rays, which unshielded cause skin cancer and destroy sea

The black market has hurt DuPont and Imperial Chemical Industries. Each spent some \$500 million developing CFC alternatives. In 1991, when DuPont started shipping HCFC 134a

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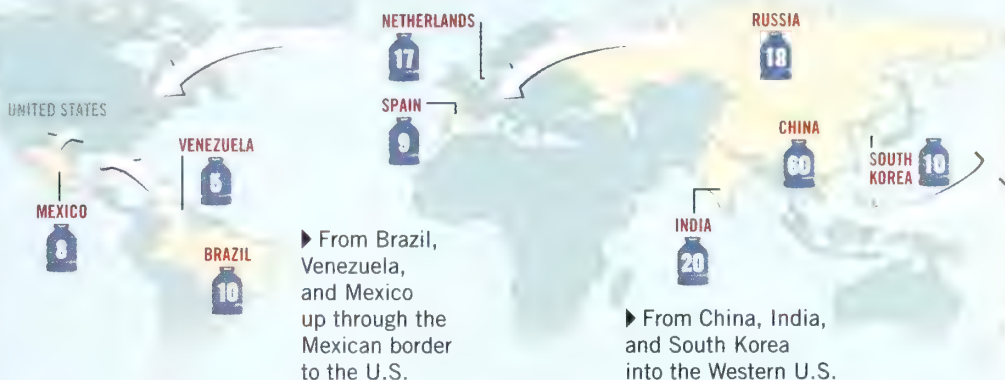
Industrialized countries are no longer allowed to produce ozone-depleting chemicals, but can still use existing stockpiles or recycled chemicals, creating a thriving black market in the Americas and Europe. Here's where the chemicals are made, and where they're going.

ZONE ACTION

COUNTRIES STILL MAKING CFCs
THOUSANDS OF METRIC TONS

THE MAIN ROUTES

► From Russia into Western Europe and Canada, where they are smuggled across the border to the U.S.



environmentally sound coolant, was a significant stockpile of CFCs. Illegal imports deferred the use of that stockpile by at least a year," says John Bray, DuPont's global manager of refrigerants. It also dampened interest in retrofitting cars and "gave a false sense of security that are readily available," says Bray. Complacency has done the atmosphere no good. This spring, the Meteorological Organization (WMO) estimated that the ozone layer over the

North Pole is the thinnest it has been since scientists started taking measurements in the early 1970s. Over Antarctica, where the layer has always been thinnest, observations last October "show a continuous ozone depletion of unprecedented magnitude, with complete annihilation...during a few consecutive weeks," says the WMO.

Part of the problem is the ease with which CFCs can be smuggled. A study of the black market issued last year by the Washington-based environmental

group Ozone Action found that illegal CFC canisters may be mislabeled as "propane" or hidden inside larger canisters of another chemical. Or they are legally brought into U.S. ports for shipment to Latin America, then diverted to the domestic market.

Customs officials stepped up enforcement in 1995, convicting eight people in Miami of diverting more than 4,000 tons of CFCs from India. Ozone Action estimates that some 10,000 tons of suspect CFCs came into U.S. ports in 1995,

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Environment

with Russian supplies going to the Coast and Chinese and Indian to West. In 1996, the trade shifted to er-to-monitor land routes across Mexican and Canadian borders.

Mexico's border is a popular point. Much of the contraband comes from a CFC factory just 200 miles from Texas. Last year, after seizing 1,000 pounds per month at the border, the Customs Service decided to shut it down. It formed a special task force with investigators from other government agencies called Operation Frijolero ("frozen Texas"). "We think of one of the top problems facing Customs," says Steven W. Hooper, deputy special agent of the Houston Customs office. "The damage that these things can do to the environment is tremendous."

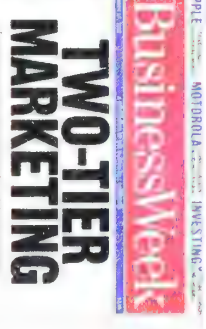
CASH INCENTIVE. In Western Europe, illegal CFCs have a Russian flavor, though Russia was to halt CFC production last year, Moscow insisted it would be too costly to produce replacements. The U.N. reports that Russia's small CFC factories produced 18,000 metric tons in 1996, some 10,000 of which entered the European Union illegally. A report on compliance with the Montreal Protocol issued last year, London's Royal Institute of International Affairs declared: "All the evidence suggests that Russia is a significant source of some of the illegally traded material.... Individual plants may simply produce above their official quota and sell the surplus on the black market."

The World Bank figures that the easiest way to stop the illegal trade is to pay Russia \$30 million to shut down the plants. The bank has come up with half the sum and urged the Group of Seven industrialized nations to cover the rest. Environmentalists want the World Bank's solution more widely applied: Shut down all CFC plants by 2010. "There is plenty of stuff floating around in cars that can be recaptured and reused," says John Vallette, executive director of the International Trade Information Service. Washington-based environmental groups say it's absurd, Vallette says, to give developing nations more time to phase out the chemical. "The majority of them go into car air conditioners. People own cars are not people in poverty."

Poor or not, drivers who won't fit air conditioners might heed a report out of the Netherlands. It estimates that up to 1.5 million cases of skin cancer could be averted each year in the U.S. if the CFC ban is enforced.

By Catherine Arnst in New York
with Gary McWilliams in Houston








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BY OTIS PORT

TER IS THICKER N CLOTS

TEN YEARS AGO, natives at the Minneapolis company now Possis Medical Inc. erred if their heavy-duty water-jet cutting devices—which were used to cut concrete off ended oil-well valves after the gulf war, could be used to clearing out arteries. If clots be excised, it would re blood flow almost ntly, unlike clot-busting drugs, which can take s to work. e hunch paid off. result is AngioJet, a stainless steel tube ng through a larger, netti-size plastic tube snakes through an y. At the end of the l tube is a tiny show- id, but facing back- . Once the device een guided to a clot, e saline solution is ed at great pressure gh the shower head, izing powerful water ointed back into the ic tube. This creates tion that whisks the clot. ssis got federal ap- al last December to he AngioJet for ing out the blood that plague kidney- sis patients—a proce- that recently saved hio man from a mas- stroke. He arrived at Cleveland Clinic with in both of the arter- at nourish the brain. robably had only tes to live, so the sis team quickly ed out one clot. Now, al trials are under on clots involved in attacks. *John Carey*

A NEW CHIP THAT'S A SURFBOARD FOR DATA

"IT'S JUST A PROTOTYPE, BUT it's the start of plasma-wave electronics," says Michael Shur, a professor of solid-state electronics at Rensselaer Polytechnic Institute (RPI) in Troy, N. Y. He's talking about a chip that marks a radical change from current technology: It transmits signals as waves, not as packets of electrons. This promises to boost computer "heartbeat" speeds from today's megahertz range—233 MHz for top-end mainstream PCs—into the gigahertz realm, or billions of cycles per second.

To explain how, Shur draws an analogy with sound. Sounds travel on waves rippling through the air, not as clumps of air molecules that

leave one person's mouth and enter another's ear. If sound worked that way, there would be a long delay while the sound-carrying molecules elbowed their way through the other air molecules. Similarly, he says, chips can harness a so-called plasma wave to send signals through the fluid of electrons within chip circuits.

Shur proposed the scheme in 1993. Now, with help from colleagues at Russia's Ioffe Institute and the University of Virginia, he has built a crude plasma-wave chip. If the research and development continues to pan out, he envisions such applications as sensors of exquisite sensitivity—they could be tuned to detect the molecular vibrations of specific substances, including explosives. Signals that surf the electron waves, says Shur, would bring "many, many exciting new opportunities." □

GET A CHARGE FROM THIS TWO-WHEELER

JUST AS POWER-ASSISTED STEERING MAKES PARKING A snap, power-assisted peddling makes biking a breeze—or not, if you want to get some extra exercise. With the Charger, a new electronic bicycle from Charger Bicycles LLC in Monrovia, Calif., you decide how much effort it takes to pump the pedals. The bike's computer chip can be set to amplify your muscle power by anywhere from 50% to 400%.

The extra oomph comes from a half-horsepower electric motor and two 12-volt batteries. They can carry a commuter up to 20 miles at an average of 18 mph before needing a recharge. San Bernardino (Calif.) commuters who agree to leave their cars at home and ride Chargers to work at least twice a week can get a reward from the city for helping to reduce air pollution: a \$600 grant toward a Charger's \$1,500 cost.



Charger Bicycles is a joint venture of AeroVironment Inc., which built the solar-powered plane flown from Paris to England in 1981, and GT Bicycles Inc., which designed the streamlined bike for the U.S. Olympic team. Production of 2,500 Chargers began in early June. *Roy Furchgott*

INNOVATIONS

THIS YEAR MARKS THE 100TH anniversary of the discovery of the electron by British physicist Joseph J. Thomson. But even a century later, after the world has been transformed by electronics, the



electron is still an enigma: How can it have mass, as it does under some conditions, yet not occupy space under other conditions? Among the Web sites celebrating the continuing conundrum: <http://www.iop.org/Physics/Electron/Exhibition> and <http://www.aip.org/history/electron>.

■ Intel Corp. has another microprocessor challenger on its hands. Centaur Technology Inc., an Austin (Tex.) unit of Integrated Device Technology Inc., has developed a Pentium-class chip that's 40% smaller than comparable Pentiums. Since silicon size is a major factor affecting costs, Centaur's IDT-C6 chip could put intense price pressure on Intel. Samples of the chip will be available in July.

■ On another roost, Intel continues to rule indisputably. The supercomputer it is installing at Sandia National Laboratories in New Mexico just broke its own world speed record: 1.34 trillion floating-point operations per second (teraflops). That's 25% better than the mark posted last December. The computer harnesses an army of 9,200 Pentium Pro chips, all marching in concert.

Cherries in winter,
peaches in spring. It's
not the weather that's
changed, it's the
packaging.

Every day, at 36,000 feet, a global exchange of sorts takes place. Millions of freshly picked items crisscross the globe, many of them gently nestled in packaging's version of a first-class seat, a carton or container designed by International Paper.

Chilean grapes land in Marseilles. California melons touch down in Warsaw. Tuscan tomatoes arrive in Kyoto. What helps them survive the trip? Package design that anticipates real-world temperature swings, humidity, jostling, customs delays, curious spiders and occasional 15-foot plunge from a cargo ship's hoist.

Packaging also has to be specific. Frozen chicken, fresh juice, fine china—each poses a very different challenge. Last year alone, our engineers designed over 44,000 distinct kinds of packaging for businesses all over the world. At a lab where we mimic the rigors of global travel, our packages are tested until they reveal their every strength and weakness. We do it for our customers, and for all of you who crave fresh, unbruised cherries in midwinter.

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A REVOLUTION IN MEDICAL IMAGING

Digirad's 50-pound device could replace 3,000-pound gamma-ray cameras

Cell phones on chips. Cameras on chips. It's amazing how many complex systems have been shrunk onto tiny slices of silicon. But in three decades of high-tech diminution, there has been one stubborn holdout: The nuclear-detection devices doctors use to diagnose cancer and arms experts require to monitor nuclear weapons.

Now, a scrappy, three-year-old startup called Digirad Corp. intends to shake up the field of gamma- and X-ray detectors. The San Diego company is producing crystal sensors mounted on semiconductors that can replace the bulky vacuum tubes in nuclear medical gear. And unlike crystal sensors used by the military, which function only when supercooled in liquid nitrogen, Digirad's crystals work at room temperature. That opens the door to dozens of applications, from smog sensors to airport detectors for thwarting transport of drugs and explosives. "We've been waiting with bated breath for this kind of thing," says Anthony D. Lavietes, an electrical engineer at Lawrence Livermore National Laboratory in Livermore, Calif.

In June, with the blessing of the Food & Drug Administration, Digirad unveiled its first product: a 50-pound imaging device that could replace 3,000-pound gamma cameras used in nuclear medicine. The product is winning raves from doctors who have field-tested it. "The images are superb," says Michael Kipper, associate professor of radiology at the University of California at San Diego.

DEEP HORIZON. Nuclear medicine could use a boost. Hospitals will spend about \$540 million on gamma cameras this year, says Frost & Sullivan in Mountain View, Calif. They'll measure bone density in osteoporosis sufferers and tissue damage in heart patients as well as detect cancers. But the market—supplied mainly by the likes of Siemens, General Electric, and Toshiba—has been languishing for years because of high equipment costs and limited uses.

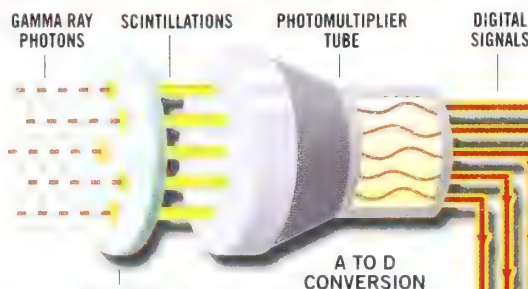
Having tried Digirad's alternative camera over a six-month period, Kip-

per thinks it could expand the boundaries of nuclear medicine. Unlike conventional gamma cameras, Digirad's products could be installed in small breast-cancer clinics, where their ability to image the breast from different angles could reduce dependence on biopsies. These compact cameras could also be placed in hospital emergency rooms

stance—whether it's a tumor or a piece of steel—emits energy differently, you can accurately measure the energy and translate it into electrical signals that can identify most materials.

For decades, scientists trying to evaluate the condition of nuclear warheads and other weapons relied on pure germanium crystals chilled in liquid

CONVENTIONAL GAMMA CAMERA

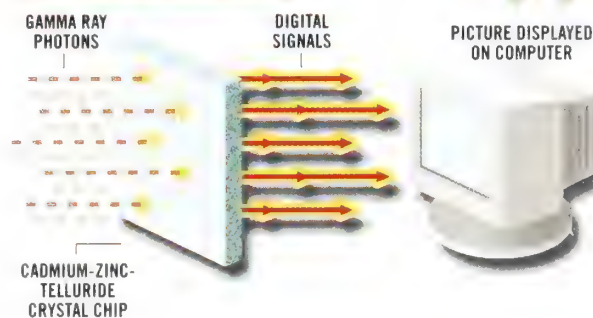


Gamma rays from tumor strike sodium-iodide crystals, creating flashes of light called scintillations.

Flashes are amplified by photomultiplier tubes, which generate a current.

Analog-to-digital converter chips change current to signals, which a computer displays as a picture.

DIGIRAD'S DETECTOR



Gamma rays strike CZT crystals-on-chips, setting electrons in motion. The chips read this current directly, without aid from converters.

The result is sharper images on the computer screen.

per to speed diagnosis of heart attacks.

The principles of gamma-ray detection haven't changed since the devices were invented in the 1960s. They all rely on crystals that generate either flashes of light or electrical signals when they absorb X-rays or gamma rays (illustration). The rays are given off naturally in the case of radioactive substances, and can be induced in most other materials—including the human body—by exciting the atoms with a radiation source. Each irradiated sub-

gen. But in the mid-1980s, Digirad founder Jack Butler and a Ukrainian laboratory named Emmanuil Rabinovich showed that a combination of cadmium, zinc, and telluride (CZT) offered excellent electrical properties at room temperature. The two men founded San Diego Semiconductor, which later became Digirad. By the early 1990s, convinced of CZT's merits, both Livermore and San Diego National Laboratories began helping Digirad analyze and test its crystals.

The payoff could be huge, says



Demand could hit \$10 billion

es, a solid-state physicist at Sandia, in addition to medical and weapons applications, James thinks CZT scientists track toxic elements in the environment, measure lead in paint, oil deposits, and separate aluminum into its alloys for recycling purposes. Contemplating all these opportunities, Digirad, President and CEO of Digirad, exuberantly predicts that demand for CZT detectors could soar to \$10 billion over the next decade.

Digirad won't be the only company to harvest that business, however. Digirad, a Newbury (Ohio) unit of the industrial giant St. Gobain, is using similar materials—assisted by physicist Raul Raskin, who parted ways with Oak Ridge in 1991. Bieron is the leading supplier of sodium-iodide crystals used in nuclear medicine. "We don't have our boat tied to a single product," says Philip J. Corvo, general manager for scintillation systems. Manufacturers of current gamma cameras, such as GE, may also enter the market. "The whole picture could change as new players get interested in this technology," says Sandia's James.

R, TOO. Analysts say Digirad has a 12-month lead over rivals in the medical arena, the biggest niche, for which it recently doubled its staff, to 53, closing a \$15 million round of venture-capital financing. That, plus a Series A placement last September, will cushion Digirad until volume sales begin in the second half of 1998. Prices for the cameras are about \$250,000, and high-end systems with a large viewing field will cost \$500,000 or more. But that's still just half the price of premium gamma cameras. Digirad hopes to list the company in 1998, at which time she'll take the company off the market's next line of products—crystal-based CT and X-ray equipment. Meanwhile, excitement over the new gamma cameras is growing. If they perform as advertised, says Arturo E. Beeche, Frost & Lounsbury's analyst covering radio pharmaceuticals, "these devices will be nothing short of revolutionary."

By Neil Gross in New York



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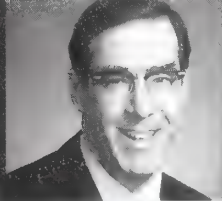
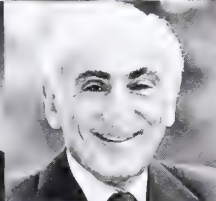
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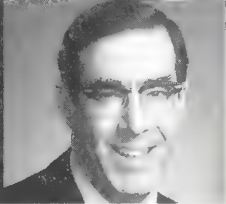
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EDITED BY KERRY CAPELL

THE NUTS AND BOLTS OF HIRING A CONTRACTOR

The contractor I hired to renovate my Manhattan apartment came highly recommended. Impressed by his credentials and eager to start the renovation,

REMODELING

I paid him \$20,000 up front. Two weeks later—when the renovation was in full swing—my “dream builder” skipped town for Singapore. He absconded with valuable art deco cabinets and a substantial chunk of my savings, leaving behind an apartment in shambles.

My case is hardly unique. Home remodeling contractors rank just behind car salespeople and auto mechanics in generating the most consumer complaints, according to the Council of Better Business Bureaus in Arlington, Va. The problem is that anyone with “a wheelbarrow and a shovel” can claim to be a contractor, says Paul K. Heilstedt, CEO of Building Officials & Code Administrators International, a municipal association in Country Club Hills, Ill.

AIRTIGHT. With no federal oversight and limited state licensing and insurance requirements, the nearly \$120 billion home remodeling industry is a hotbed of unqualified—and often unscrupulous—operators. Your best defenses against renovation ripoffs are a little skepticism, a lot of comparison shopping, and an airtight legal contract.

Whether you are remodeling the kitchen or considering a more elaborate project, the best person to lead you through the lengthy and often frustrating process is an experienced architect. While this will add 10% to 15% to

your overall cost, consider it money well spent. An architect will design the project and oversee it from start to finish. And a good designer helps you avoid unforeseen problems, says Robert A. Rubin, a partner in the Manhattan law firm of Postner & Rubin. The American Institute of Architects (AIA) (800 242-9930) can provide a list of registered architects in your area who specialize in remodeling.

Once you've chosen an architect, you'll need to spell out the conditions and the expected budget of the project in a written contract. Whether you hire an attorney to draw up the papers or use a copy of a standard remodeling contract obtainable from the AIA, it should at minimum cover the following: the method and timetable for payment; a comprehensive listing and timetable of the architect's

services, including a list of specifying the frequency of site visits; and evidence that the architect has liability insurance. If the remodeling project is more complex, a construction attorney—usually run from \$1,000 to \$5,000—is recommended.

Although the architect should monitor the renovation, you still need to stay involved. Review all sketches and plans early in the process.



asier to modify a de-
paper than to knock
walls later. After you
the design, the con-
on documents will be
obtain building per-
d generate bids from
tors.

, the architect can re-
to contractors who
successfully completed
projects. But you'll
ed to do a back-
check, says Manhat-
estigator Michael G.
, whose firm investi-
dozen cases of con-
fraud each year. A
scenario, he says, is
ntractor who bills
wners for fictitious
s and employees.

CKS. On rare occa-
an unscrupulous ar-
may be receiving
ks from the contrac-
the referrals, so it is
ant to investigate
ackgrounds and cre-
s independently.

's why you'll need to
tle detective work of
m. First, request ref-
l. Check a few of the
tor's recent renova-
objects and interview
newowners.

don't stop there. Talk
subcontractors—elec-
, plumbers, and car-
—who were involved
ious renovation pro-
nd find out whether
ave been paid on
le. If the contractor
ot pay them for work
project, any or all of
contractors can place
on your property—
ough you have al-
paid the general
tor.

t's more, make sure
e contractor has both
y and workers' com-
on insurance. Ask the
for a copy of the in-
e certificate, advises
Patchan, executive
r of the National As-
on of Home Builders
elors Council in Wash-
. Using the policy
r on the certificate,
he carrier to check
er the policy is still

current and if it covers a
project such as yours. Also,
call the Worker's Compensa-
tion Commission in your
state to determine whether
or not the contractor is ac-
tually covered.

Although insurance and
registration requirements vary
widely, the National Associa-
tion of the Remodeling Indus-

sumers fall into the trap of
simply hiring the lowest bid-
der. "Don't put price first,"
says Patchan. "A bid without
you having checked out that
company is not a bid worth
looking at." Indeed, a very
low bid may mean that the
contractor urgently needs
your money to finance other
work, Rubin says.

BUILDER CHECKLIST

REFERENCES Ask for a list of recent remodel-
ing jobs and interview the homeowners.

CREDENTIALS Call the Consumer Affairs
Dept. in your area to find out if the contractor
is properly licensed and registered with the
state. The local Better Business Bureau can
warn of any complaints.

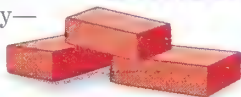
INSURANCE Get a copy of the contractor's
liability insurance policy and call the carrier
to confirm that it is current. Call the Worker's
Compensation Commission in your state to
make sure the contractor is covered.

CO-WORKERS Request the names and
phone numbers of all recent subcontractors
that the general contractor has hired and find
out if they are getting paid on time.

CANCELLATION POLICY Federal law
requires contractors to provide written notice
explaining that the contract may be canceled
up to three business days after signing it.

DATA: BUSINESS WEEK

The problem is that anyone with
"a wheelbarrow and a shovel" can
claim to be a contractor



try (800 966-7601, ext. 3022)
will tell you what licensing or
registration, if any, is required
in your state. It's also a good
idea to call your local Con-
sumer Affairs Bureau and
Better Business Bureau to find
out if the home remodeler has
generated any complaints.

Only now is it time for a
serious price comparison. The
bids should itemize the time
and costs for all labor and ma-
terial. However, many con-

Once you've narrowed the
field to the one candidate who
meets all these specifications,
you're ready to draw up the
contract. Again, the architect
can supply you with a stan-
dard AIA contract that applies
to your project. But your
best protection is to hire a
construction lawyer who can
customize the contract and
advise you on problems rang-
ing from project delays to
billing disputes.

At a minimum, the legal
agreement between the con-
tractor and the homeowner
should include the following: a
clause that permits cancella-
tion within 72 hours after
signing the contract; a list of
all drawings and specifications
outlining the scope of work;
the names and addresses of
all people working on the job;
the total cost of the renova-
tion and a breakdown of all
labor and material charges; a
one-year guarantee of the
contractor's workmanship;
approximate date of comple-
tion; a plan to settle poten-
tial disputes; and a release
of lien clause, which will pro-
tect you in the event the
subcontractors never get
paid.

CONTENTIOUS. But by far
the most contentious item
in the contract is the
method and schedule for
payment. Typically, contrac-
tors receive an advance pay-
ment of 15% to 20% of the
stipulated sum after the con-
tract is signed and before the
renovation begins. Attorneys
recommend stating in the
contract that this advance
will be applied against the
first phase of work completed
by the contractor. Then, pay-
ments will be made at vari-
ous stages of the job's
progress.

By contractually arrang-
ing to withhold 10% of each
payment until completion, you
can ensure that the contrac-
tor finishes the renovation
right down to the last item,
says Manhattan architect
William G. Green. Before you
sign the "certificate of com-
pletion," get an itemized
breakdown of final details to
be completed. And even
though you have agreed to a
release of lien clause in your
contract, make sure the
builder provides you with the
document before making the
final payment.

It may seem as if finding a
good contractor is more work
than the renovation itself. But
by making the extra effort at
the outset, you'll save a huge
amount of money, annoyance,
and time. *Heike Wipperfurth*

FEASTS FOR THE EYE: THE NEW CD-ROM GAMES

Don't count CD-ROMs out yet. True, only a few years ago, CD-ROMs were the great hope of the computer industry. Then Web mania struck, and the shiny disks lost some of their luster. But still, there are several unusual and challenging CD-ROMs that should not be missed. Indeed, the following are a collection of visually rich titles that go well beyond the creativity of the traditional shoot-'em-up game. As a Macintosh owner, I included only titles available for both Mac and PC platforms.

SegaSoft's *Obsidian* is ingenious and one of the best realized CD-ROMs I've seen. The game takes you through five beautifully rendered worlds, each with its own set of physical laws. In the first world—a funny bureaucratic nightmare of clerks to be placated and forms to be authorized—the player literally climbs the walls in search of the necessary paperwork. Floors become walls, and walls become ceilings as your orientation in the labyrinth shifts. The game features the kind of logic problems schoolkids hate. Here, though, they are made fun and even magical.

ART FORM. Another noteworthy game comes from English musician Peter Gabriel. *Eve* is a collaboration between Gabriel and artists Helen Chadwick, Yayoi Kusama, Cathy de Monchaux, and Nils-Udo that tries to expand the visual and conceptual parameters of the CD-ROM as an independent art form.

Expelled from paradise, you arrive in a world of mud. As you gather artwork and fragments of Peter Gabriel

from Japanese rock garden to English countryside to industrial grime and, finally, to either apocalyptic wasteland or paradise regained.

There is, however, a snake in the garden. Throughout the game you are forced to spend an inordinate amount of time listening to Gabriel's thoughts on relationships—about the equivalent of a good day of

Oprah. "What I need is not always what I want," Gabriel tells us with painful sincerity, then drops the other shoe with: "What I want is not always what I need."

To increase the resemblance to a daytime talk show, Gabriel has invited along a panel of "experts," from psychologists to clerics, who utter banalities such as: "Men are often unclear in the way they communicate." But exasperating as it is, *Eve* creates a visually engrossing environment, by

turns lovely and frightful.

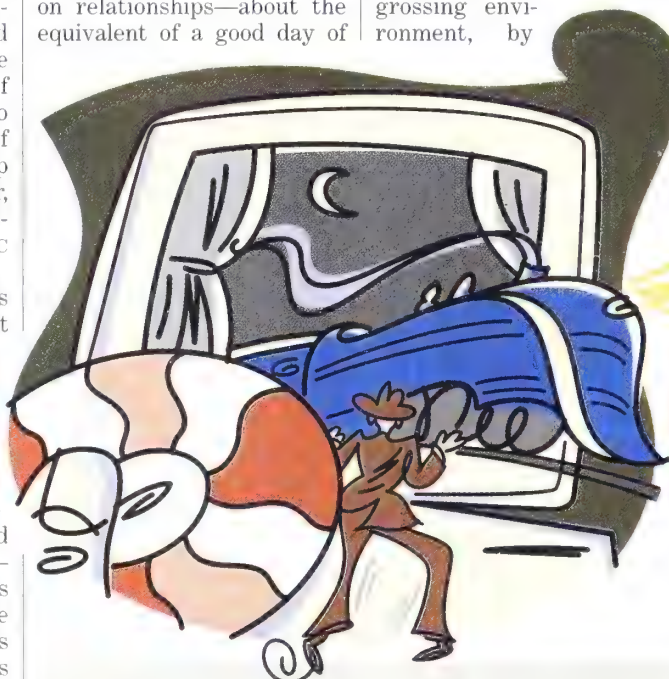
While Pulse Entertainment's *Bad Mojo* is excellently rendered, the setting is decidedly more grotesque. Here, you play a character living over a mission, if you can, down your clues about your past, crawling around the city's less-than-tidy environment. What makes the game memorable is the tremendous ingenuity that went into creating a roach-eye view world.

LABOR OF LOVE. The landscape is more pleasing than Dan Mechner's *The Last Express*, which offers a detailed recreation of a legendary train, the pre-World War I Orient Express. Mechner, what was obviously a labor of love, tracked down the main car from the Orient Express for use as a museum.

A leisurely and complex game, *The Last Express* often requires you to listen and observe the intricate lives of the other characters. Instead of, say, shooting them right, as you wander through the train, searching for clues to your best friend's murder. Sometimes necessary to eavesdrop on passengers in order to plot your next move.

There are so many eavesdropping opportunities that you can hear simultaneous conversations from different parts of the train. It is impossible to hear them all in one game. Action should probably look elsewhere, because *The Last Express* reveals itself as a masterpiece. Those who stay with it, though, will be rewarded with both a meticulous historical reconstruction and a nuanced narrative.

These games offer a variety of virtual experiences found elsewhere—indeed, on the Net. So whether you want to befriend a cockroach or emote with Peter Gabriel, pop in a CD-ROM disk. *By*



More Than Just a Game

The following CD-ROM titles combine art, puzzles, and detailed narratives with high-tech visual imagery:

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BAD MOJO Pulse Entertainment	\$55.95	Crawl under doors and down sewers: a night in the life of a roach
EVE Real World MultiMedia	49.95	A rich audiovisual journey from mud to paradise—but watch out for those self-help gurus
THE LAST EXPRESS Broderbund Software	49.95	Train enthusiasts will love the detailed recreation of the last days of the Orient Express
OBSDIAN SegaSoft	49.95	Enter the fun house of physics where the rules shift with the spaces

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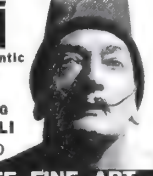


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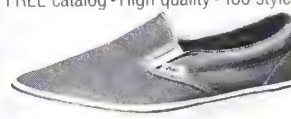
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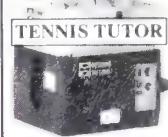
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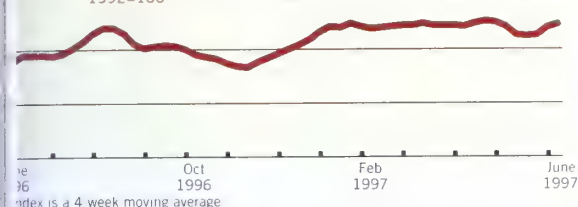
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June 14=122.3
1992=100



The production index continued to edge higher in the week ended June 14. Calculation of the four-week moving average, however, the production index dropped to 122.1, from 123.3 in the previous week. In the latest week, year-adjusted auto output was down sharply, and there were declines in related production: electric power, coal, and crude-oil refining. Output of steel and lumber increased for the week.

Source: Index compiled by The McGraw-Hill Companies

PRICES

	LATEST WEEK	WEEK AGO	YEARLY % CHG
PRICES (6/20) S&P 500	898.70	893.27	34.8
LATE BOND YIELD, Aaa (6/20)	7.33%	7.44%	-5.3
RAW MATERIALS PRICES (6/20)	105.9	106.5	0.5
STOCKS FAILURES (6/13)	NA	NA	NA
STATE LOANS (6/11) billions	NA	NA	NA
SUPPLY, M2 (6/9) billions	\$3,907.0	\$3,909.7r	4.5
CLAIMS, UNEMPLOYMENT (6/14) thous.	347	339r	-2.3

Source: Standard & Poor's, Moody's, Journal of Commerce (index: 1990=100), Federal Reserve, Labor Dept.

INTEREST RATES

	LATEST WEEK	WEEK AGO	YEAR AGO
MORTGAGE FUNDS (6/24)	5.39%	5.46%	5.15%
GOVERNMENT PAPER (6/25) 3-month	5.63	5.64	5.80
GOVERNMENT DEPOSIT (6/25) 3-month	5.66	5.65	5.48
MORTGAGE (6/20) 30-year	7.81	7.90	8.50
FIXED RATE MORTGAGE (6/20) one-year	5.87	5.98	6.08
LIBOR (6/20)	8.50	8.50	8.25

Source: Federal Reserve, HSH Associates, Bloomberg Financial Markets

PRODUCTION INDICATORS

	LATEST WEEK	WEEK AGO	YEARLY % CHG
STEEL (6/21) thous. of net tons	2,149	2,092#	7.3
AUTOS (6/21) units	134,077	121,769r#	3.8
TRUCKS (6/21) units	127,244	129,462r#	6.5
ELECTRIC POWER (6/21) millions of kilowatt-hrs.	67,042	61,893#	-5.2
CRUDE-OIL REFINING (6/21) thous. of bbl./day	15,052	15,080#	5.6
COAL (6/14) thous. of net tons	20,428#	20,628	-3.4
LUMBER (6/14) millions of ft.	516.3#	496.7	7.4
RAIL FREIGHT (6/14) billions of ton-miles	26.4#	26.5	-1.5

Sources: American Iron & Steel Institute, Ward's Automotive Reports, Edison Electric Institute, American Petroleum Institute, Energy Dept., WWPAl, SFFA2, Association of American Railroads

PRICES

	LATEST WEEK	WEEK AGO	YEARLY % CHG
GOLD (6/25) \$/troy oz.	338.450	341.600	-11.8
STEEL SCRAP (6/24) #1 heavy, \$/ton	138.50	138.50	0.0
COPPER (6/20) \$/lb.	124.1	121.7	18.1
ALUMINUM (6/20) \$/lb.	75.6	77.0	8.3
COTTON (6/21) strict low middling 1-1/16 in., \$/lb.	71.15	70.82	-10.9
OIL (6/24) \$/bbl.	18.47	18.87	-7.1
CRB FOODSTUFFS (6/24) 1967=100	241.95	242.89	-12.4
CRB RAW INDUSTRIALS (6/24) 1967=100	335.36	338.52	1.4

Sources: London Wednesday final setting, Chicago market, Metals Week, Memphis market, NYMEX, Commodity Research Bureau

FOREIGN EXCHANGE

	LATEST WEEK	WEEK AGO	YEAR AGO
JAPANESE YEN (6/25)	114.03	113.43	109.98
GERMAN MARK (6/25)	1.73	1.73	1.53
BRITISH POUND (6/25)	1.66	1.64	1.55
FRENCH FRANC (6/25)	5.82	5.85	5.15
ITALIAN LIRA (6/25)	1683.5	1697.5	1535.6
CANADIAN DOLLAR (6/25)	1.39	1.39	1.37
MEXICAN PESO (6/25) ¹	7.940	7.909	7.603
TRADE-WEIGHTED DOLLAR INDEX (6/25)	103.4	103.4	97.9

Sources: Major New York banks. Currencies expressed in units per U.S. dollar, except for British pound in dollars. Trade-weighted dollar via J.P. Morgan

1=Western Wood Products Assn. 2=Southern Forest Products Assn. 3=Free market value NA=Not available r=revised NM=Not meaningful

THE WEEK AHEAD

FINANCIAL INCOME

June 30, 8:30 a.m. EDT ▶ Personal income likely rose 0.4% in May, while consumption was up 0.3%, according to the latest forecast of economists surveyed by The McGraw-Hill Companies. In April, income and spending advanced just 0.1%.

HOME SALES

June 30, 10 a.m. EDT ▶ Homes likely at an annual rate of 775,000 in May, up 7.7% to 772,000 in April.

MEETING

July 1 ▶ The Federal Reserve's Open Market Committee will meet to

set monetary policy for the next six weeks. All the economists surveyed by MMS expect the Fed to leave short-term interest rates unchanged. The policy meeting continues on July 2.

NAPM SURVEY

Tuesday, July 1, 10 a.m. EDT ▶ The National Association of Purchasing Management's index likely stood at 57% in June. That's hardly changed from May's 57.1%.

LEADING INDICATORS

Tuesday, July 1, 10 a.m. EDT ▶ The Conference Board's index of leading indicators probably rose 0.2% in May, after a small 0.1% slip in April.

CONSTRUCTION SPENDING

Tuesday, July 1, 10 a.m. EDT ▶ The MMS consensus expects that building outlays rose 0.5% in May, after falling 1% in April.

FACTORY INVENTORIES

Wednesday, July 2, 10 a.m. EDT ▶ Factory inventories probably rose a modest 0.3% in May, half the 0.6% gain in April.

EMPLOYMENT

Friday, July 3, 8:30 a.m. EDT ▶ The MMS median forecast calls for a 228,000 increase in June nonfarm payrolls. That's far stronger than the 138,000 gain posted in May. The June unemployment rate likely edged up to 4.9%, from May's 4.8%.

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Index to Companies

This index gives the starting page for a story or feature with a significant reference to a company. Most subsidiaries are indexed under their own names. Companies listed only in tables are not included.

A

ABC 48
Alcatel Telecom (ALA) 47
Allianz 52
Allied Waste Industries (AWIN) 119
Aluminum Co. of America (AA) 39
AMC (AEN) 46
America Online (AOL) 48
AMG Data Services 116
Amoco (AN) 41
Anglo American 94
Ardent Communications 47
Astra (A) 12
AT&T (T) 122, 130E, 142
Atlantic Richfield (ARC) 41

B

BankAmerica (BAC) 98
BAT Industries 36
Bay Networks 47
Bear Stearns (BSC) 120
Berg Electronics (BE) 45
Bicron 134
Boeing (BA) 6
Brown & Williamson Tobacco 36
Burnham Securities 40

C

Cabletron Systems (CS) 47
Canon 100
Cap Ventures 100
Carmike Cinemas (CKE) 46
Caterpillar (CAT) 30B, 51
Celadon Trucking Services 45
Centaur Technology 131
Charger Bicycles 131
Chevron (CHV) 98
Chrysler (C) 6, 40, 52
Cinemark USA 46
Cisco Systems (CSCO) 47
Citibank (CCI) 6, 30
Citicorp (CCI) 118
Clear Channel Communications (CCU) 48
CNET 48
Coastal (CGP) 41
Cobb Theaters 46
Coca-Cola (KO) 30B, 44, 52, 100, 116
Colgate-Palmolive (CL) 115
Columbia/HCA Healthcare (COL) 110
Commodity Systems 8
Compaq Computer (CPQ) 6, 48, 52
Cowen & Co. 46

D

Dai-ichi Kangyo Bank (DAIKY) 118
Daimler Benz 52
Dell Computer (DELL) 52
Deutsche Morgan Grenfell 47, 48
Deutsche Telekom 52
Digirad 134
Digital Equipment (DEC) 48

D

Donaldson Lufkin & Jenrette (DLJ) 116, 120
Dorsey & Whitney 47
Dow Jones News Service (DJ) 8
Dun & Bradstreet (DNB) 8
DuPont (DD) 41, 100, 128

E

Eastman Kodak (EK) 100, 108
Elf Aquitaine 41
Eli Lilly (LLY) 48
Enterprise Hydraulic Works 21
Epson 100
ESC 126
Excite! 48
Exxon (XON) 6, 41, 48

F

Federated Department Stores (FD) 122
Fidelity Investments 118
First Call 8
Fisher Price (MAT) 45
Ford Motor (F) 6, 40
Fore (FORE) 47
Frost & Sullivan 134
Fuji Film 100

G

Gazprom 94
General Electric (GE) 100, 116, 134
General Motors (GM) 40
Gillette (G) 44, 100
Global Internet Software Group 47
Globalstar 116
Goodyear Tire & Rubber (GT) 44
Grand Metropolitan (GRM) 47
GT Bicycles 131

H

Herzog Contracting 119
Hewlett-Packard (HWP) 100, 108
HFS (HFS) 122
Hindustan Lever 94
Home Box Office (TWX) 115
Honda (HMC) 40

I

IBM (IBM) 100
Imperial Chemical Industries (ICI) 128
Integrated Device Technology (IDI) 131
Intel (INTC) 52, 131
International Data 100
Invesco High-Yield Fund 116
Indium 116
ITI Industries (IIN) 45

K

KDP Investment Advisors 116
Kemper High-Yield Fund 116
Kinko's 100
Kirk Marback 122
Konica 100
Kraft Foods (MO) 36

L

Ladenburg Thalmann 8
Lehman Brothers (LEH) 6, 52
Liggett Group (BGL) 36
Liposome 48
Live Picture 100
Loews (LTR) 36
Logo Athletic (TTX) 115
Lucent Technologies (LU) 45
Lukoil 94
Lyra 108

M

Madge Networks (MADGF) 47
Maxum Medical (MAM) 122
May Department Stores (MA) 122
McGraw-Hill (MHP) 41
Mercantile Stores (MST) 122
Mercer Management Consulting 41
Mercury Asset Management 118
Merrill Lynch (MER) 8, 94, 116, 118
Microsoft (MSFT) 6, 23, 52, 100
Miller Brewing (MO) 36
Mobil (MOB) 41
Moody's Investors Service (DNB) 116
Morgan (J.P.) (JPM) 119
Morgan Stanley (MS) 52, 94, 100
Morgan Stanley Dean Witter (MS) 41, 118
Motorola (MOT) 108

N

National Amusements 46
NatWest Securities (NW) 41
NBC (GE) 48
New World Development 52
Nike (NKE) 44
Nikon 100
Nintendo 16
Novartis 52

O

OakMark Fund (OAKMX) 36

P

Pacific Telesis (PAC) 98
Palm Computing 23
Paxon Communications (PXN) 48
Pennzoil (PZL) 41
Petrobras 94
Pharmacy Fund 6
Philip Morris (MO) 34, 36
Phillips Petroleum (P) 41
Pillsbury 47
Possis Medical 131
Postner & Rubin 142
Prudential Securities 41

Q

Quintel Entertainment (QTEL) 122
Quorum Health Group (QHG) 110
Qwest Communications 48

R

Rapid City Communications 47
Regal Cinemas (REGL) 46
Regional Financial Associates 126
Resource Forum 6
RJR Nabisco (RN) 36
Robertson Stephens 47
Royal Dutch/Shell Group (RD) 41

S

Salomon Brothers (SB) 100, 126
Samsung Electronics 9
Schröder Münchmeyer Research 52
Securities Data 41
Sega 16
SegaSoft 142
Sharp 23
Showtime Networks 11
Siemens 52, 134
Smith Barney (SB) 6, 3
Sony (SNE) 16, 46, 52
South African Breweries
Southern New England Telecommunications (S)
St. Gobain 134
Standard & Poor's (MHP) Stephens 110
Sweet Art 100
Swisher International (SWR) 8

T

Takeda Chemical Industries
Tandem Computers (TD)
Telebrás 94
Tennet Healthcare (THC)
Tenneco (TEN) 51
Texaco (TX) 41
3Com (COMS) 23, 47
Time Warner Sports (TW)
Top Rank 115
Toshiba 134
Total (TOT) 41
Toyota (TOYOT) 40, 118
T. Rowe Price 34
Tsim Sha Tsui Properties
Turner Broadcasting (TW)

U

Union Pacific (UNP) 41
Union Pacific Resources (UPR) 41
United Airlines (UAL) 98
USA Network 16
USA Waste Services (UW)
U.S. Robotics (USRX) 47
UST (UST) 36

V

Viking 21
Visa 6
Volkswagen 52

W

Walt Disney (DIS) 48
Wilshire & Associates 1

X

Xircom 47
XyLan (XYLN) 47

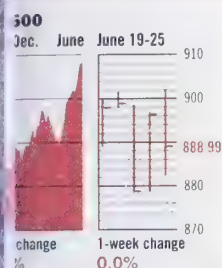
Y

Yahoo! (YHOO) 48

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Investment Figures of the Week

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NTARY
ely skittish. That's the
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ustrials plummeted 192
on June 23 in the wake
e Minister Hashimoto's
s that Japan might sell
asuries. But when the
se backed off, the Dow
mightily the next day,
ing 80% of the loss.
of some Treasury sell-
a foreign central bank
t day sent stocks tum-
gain. The sell/buy ratio
ers activity, shown on
ge, though still posi-
moving toward negative

U.S. MARKETS

	Latest	% change Week	Year
Dow Jones Industrials	7690.0	-0.4	34.5
NASDAQ Combined Composite	1446.2	1.0	23.3
S&P MidCap 400	287.1	-0.8	22.6
S&P SmallCap 600	158.9	-0.2	19.6
S&P SuperComposite 1500	189.8	-0.1	31.3

SECTORS

	Latest	% change Week	Year
Bloomberg Information Age	269.3	0.1	32.2
S&P Financials	102.2	-1.0	53.0
S&P Utilities	195.9	-0.5	1.9
PSE Technology	286.7	0.9	39.0

FOREIGN MARKETS

	Latest	% change Week	Year
London (FT-SE 100)	4640.0	-0.4	26.1
Frankfurt (DAX)	3798.5	1.8	47.6
Tokyo (NIKKEI 225)	20,679.3	0.9	-8.5
Hong Kong (Hang Seng)	15,065.0	6.1	37.2
Toronto (TSE 300)	6515.1	0.3	28.5
Mexico City (IPC)	4397.8	2.7	39.2

FUNDAMENTALS

	Latest	Week ago	Year ago
S&P 500 Dividend Yield	1.66%	1.66%	2.15%
S&P 500 P/E Ratio (Last 12 mos.)	22.8	22.6	19.1
S&P 500 P/E Ratio (Next 12 mos.)*	18.5	18.4	NA
First Call Earnings Revision*	-1.30%	-1.25%	NA

TECHNICAL INDICATORS

	Latest	Week ago	Reading
S&P 500 200-day average	768.5	762.6	Positive
Stocks above 200-day average	78.0%	78.0%	Negative
Options: Put/call ratio	0.49	0.57	Negative
Insiders: Vickers Sell/buy ratio	1.81	1.43	Positive

Data: Bloomberg Financial Markets; *First Call Corp.

BEST-PERFORMING GROUPS

	Last month%	Last 12 months%
Personal Loans	17.8	Savings & Loans 80.8
Broadcasting	14.9	Semiconductors 73.7
Invest. Banking/Brkrge.	14.2	Invest. Banking/Brkrge. 72.2
Medical Prods. & Suppls.	13.6	Oil & Gas Drilling 64.9
Drugs	13.2	Instrumentation 56.5

WORST-PERFORMING GROUPS

	Last month%	Last 12 months%
Oil Exploration & Prod.	-9.8	Gold Mining -23.6
Photography/Imaging	-7.9	Engineering & Constr. -14.3
Airlines	-6.7	Photography/Imaging -7.6
Metals	-5.3	Manufactured Housing -5.1
Gold Mining	-5.2	Defense Electronics -3.0

BLOOMBERG MONEY FLOW ANALYSIS

Rebound ahead? Stocks with most significant buying on price weakness

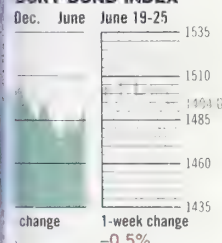
	Price	1-month change
Compaq Computer	102 3/4	-4 1/8
Amoco	88 1/4	-3/8
Micron Technology	40 15/16	-1 1/16
Texas Instruments	88 7/16	-7 1/16
MCI Communications	38 9/16	-3/16
Nordstrom	47 1/16	-1/2

Decline ahead? Stocks with most significant selling on price strength

	Price	1-month change
Microsoft	132 1/16	5 7/16
Dell Computer	123	9 3/4
WorldCom	30 3/4	4 3/4
3Com	49 3/4	3
Philip Morris	44 3/16	3/16
Quantum	21 15/16	2

BEST RATES

TREASURY BOND INDEX



KEY RATES

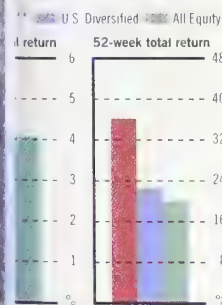
	Latest week	Week ago	Year ago
MONEY MARKET FUNDS	5.15	5.16	4.90
90-DAY TREASURY BILLS	5.10	5.03	5.24
6-MONTH BANK CDS	5.19	5.21	4.99
1-YEAR TREASURY BILLS	5.63	5.66	5.82
10-YEAR TREASURY NOTES	6.44	6.40	6.91
30-YEAR TREASURY BONDS	6.74	6.69	7.06
LONG-TERM AA INDUSTRIALS	7.23	7.18	7.60
LONG-TERM BBB INDUSTRIALS	7.64	7.61	7.99
LONG-TERM AA TELEPHONES	7.47	7.42	7.85

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 31% federal tax rate.

	10-yr. bond Latest week	10-yr. bond Last week	30-yr. bond Latest week	30-yr. bond Last week
GENERAL OBLIGATIONS	4.75%	4.71%	5.32%	5.28%
PERCENT OF TREASURIES	73.76	73.74	79.00	79.01
TAXABLE EQUIVALENT	6.88	6.83	7.71	7.65
INSURED REVENUE BONDS	4.88	4.82	5.53	5.47
PERCENT OF TREASURIES	75.78	75.46	82.12	81.86
TAXABLE EQUIVALENT	7.07	6.99	8.01	7.93

MUTUAL FUNDS



EQUITY FUNDS

Leaders	Four-week total return	%	Laggards	Four-week total return	%
American Heritage	23.5		United Svcs. Gold Shares	-13.8	
Invesco Worldwide Cap. Gds.	12.5		Frontier Equity	-13.5	
Morgan Stan. Inst. Lat. Am. A	12.2		Bull & Bear Gold Investors	-11.8	
Lexington Troika Russia	12.1		Fontaine Global Growth	-11.1	
Morgan Stan. Latin Amer. A	11.9		Morgan Stan. Inst. Gold A	-10.8	
Leaders	52-week total return	%	Laggards	52-week total return	%
Morgan Stan. Inst. Lat. Am. A	61.3		Frontier Equity	-56.5	
Morgan Stan. Latin Amer. A	59.3		United Svcs. Gold Shares	-47.1	
Legg Mason Value Primary	56.1		Bull & Bear Gold Investors	-37.0	
Fidelity Select Home Finance	55.5		Morgan Stan. Inst. Gold A	-36.7	
Fidelity Select Brokerage	55.5		Lexington Strategic Invmts.	-34.4	

EQUITY FUND CATEGORIES

Leaders	Four-week total return	%	Laggards	Four-week total return	%
Latin America	9.5		Precious Metals	-7.8	
Financial	8.6		Natural Resources	-0.7	
Health	6.6		Technology	-0.3	
Communications	6.2		Europe	2.6	
Diversified Emerging Markets	6.1		International Hybrid	3.1	
Leaders	52-week total return	%	Laggards	52-week total return	%
Financial	47.1		Precious Metals	-25.9	
Latin America	40.2		Japan	-6.9	
Real Estate	31.5		Diversified Pacific/Asia	3.0	
Large-cap Blend	30.4		Small-cap Growth	3.6	
Large-cap Value	30.1		Pacific/Asia ex-Japan	8.4	

as of market close Wednesday, June 25, 1997, unless otherwise indicated. Industry
ude S&P 500 companies only. Fundamentals, technical indicators, Bloomberg mon-

ey flow analysis, and mutual fund returns are as of June 24. For a more detailed explanation, write
to us or E-mail figures@businessweek.com. NA=Not available **Vanguard Index 500 Fund

TOBACCO: WHERE'S THE FIRE?

What's the hurry? That's our reaction to the rush to settlement on the tobacco front. The pact is only a broad-strokes agreement that could—repeat, could—lead to a decent deal once it has gone through the Washington legislative mill. There's the rub. We need to see the political fine print. After all, we're talking about negotiations involving the two biggest campaign contributors, trial lawyers and tobacco companies. We've got long-standing ideological issues at stake, from the fate of the Food & Drug Administration to government's role in the nation's health. Toss in pity for tobacco farmers (subsidized by taxpayers), victims of cancer (who just might have some personal responsibility in their smoking), and this promises to be a giant spectacle. Given this intensely political arena, we want transparency in the upcoming negotiations, and the time to see just who is agreeing to what, and why.

So far, the focus of the tobacco talks has been on money and liability. In exchange for forking over \$368.5 billion for their sins, the tobacco companies get to limit their liability. O.K. But the sine qua non of any settlement must be the public health. Bottom line: The deal has to produce a dramatic decline in teenage smoking. The anomaly of 90% of all nicotine addiction beginning in an age group that cannot legally purchase cigarettes has to end. The system of penalties and rewards proposed to accomplish this task doesn't even come close. The industry promises to cut youth smoking by 30% in five years, 50% in seven years, and 60% in 10 years, or pay a

fine of \$80 million per percentage point by which the target is missed. Let's try 10% a year and a fine of \$800 million point. And toss the 75% refund if a tobacco company doesn't hit the targets but does try hard. Results are the only that count.

Next, let the FDA regulate. On paper, the agreement gives the agency authority to cut levels of nicotine. But it then imposes insurmountable hurdles before the agency can act. The most absurd would have the FDA prove that ratcheting nicotine in cigarettes would not generate "significant demand for contraband." Huh? The agreement also allows the tobacco industry to take the FDA to court to dispute its evidence about contraband. This whole issue of contraband is ridiculous. If the settlement is to lower the level of addiction among teenage Americans, the FDA must have regulatory power to adjust nicotine levels. Period.

To get the kind of deal that focuses on public health, state attorneys general should also continue to litigate the cases and keep the pressure on Big Tobacco. The AGs should demand a halt to prosecution while they negotiated a big-bucks settlement. But public health, not money, must be the focus. That's why there's no need to rush to settlement. This must work for society, not just special interests. To this end, it should stop the relentless marketing of cigarettes to children. Unfortunately, it cannot force adults to take personal responsibility for their own choices. That, they must do on their own.

GLOBAL WARMING NEEDS COOL HEADS

The issue of global warming throws off more ideological heat than scientific light or economic insight. Five years after the first Earth Summit in Rio de Janeiro, what we don't know is still a multiple of what we do know. The science is better but not good enough. The good intentions of well-meaning people notwithstanding, caution and not crisis should guide U.S. policy in reducing greenhouse gases. The U.S. should not ignore the potential harm from global warming but it must act pragmatically, not emotionally.

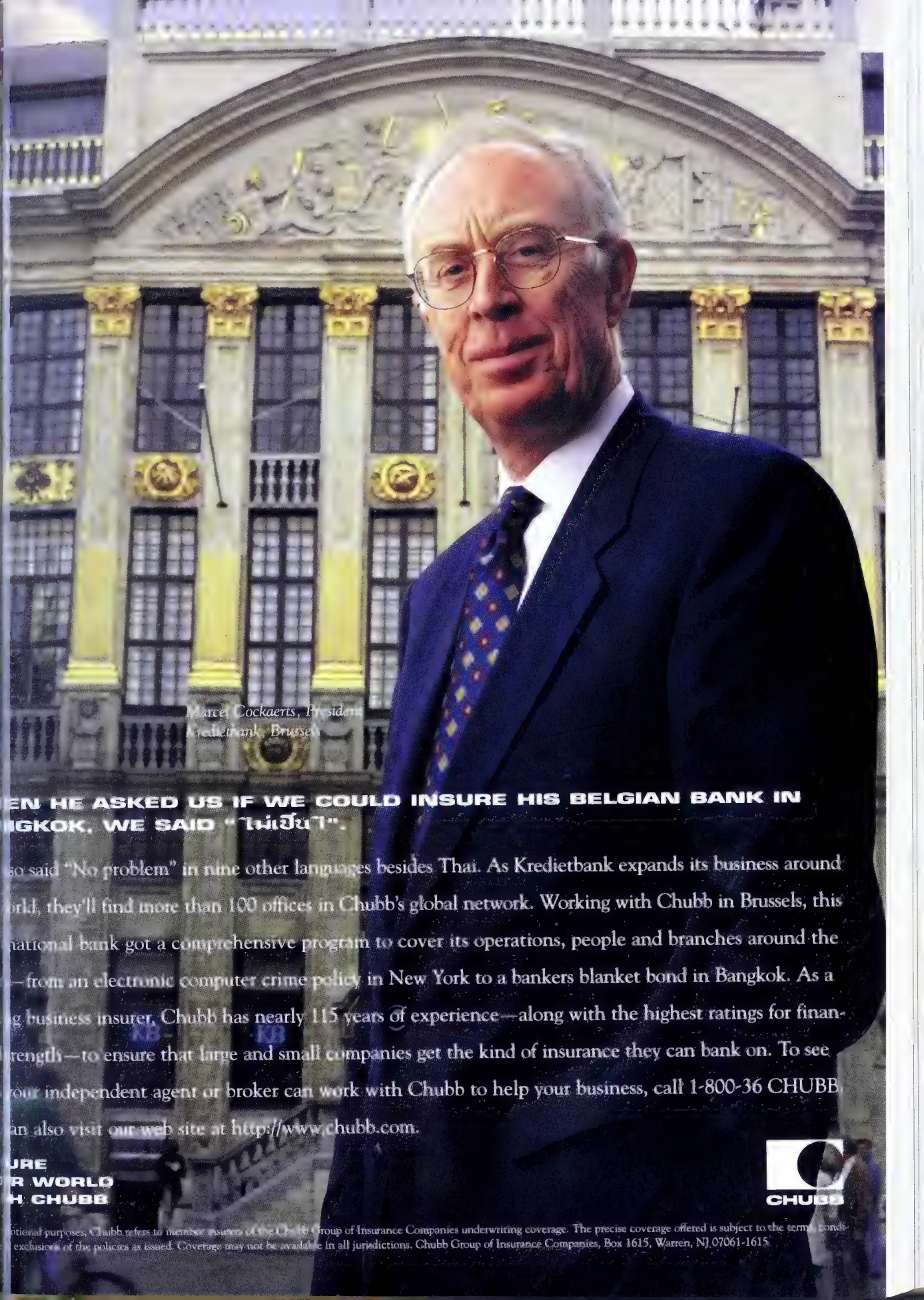
What do we really know about global warming? Rising temperatures are the only certainty. But how much, how fast, and how important it is are all open to question. Estimates go from 1.8 degrees Fahrenheit to 6.3 over the next century, under current rates of burning coal, gas, and oil. No one knows if rising temperatures will melt the polar ice caps and flood Seattle or just extend the growing season for corn.

What would be the economic impact of curbing global warming? Who knows? Cutting U.S. carbon emissions by 40% by 2020 and returning them to 1990 levels could reduce economic output by 8% or even raise it by 5%, according to the World Resources Institute. It depends on assumptions

about alternative fuels, international cooperation, conservation, and curbs on burning fossil fuels.

The only sensible thing for the U.S. to do with these data is to take out insurance. The Cassandras in the 1970s were wrong about shrinking natural resources and limits to growth. But over time, the temperature is really rising. What to do? The industry has dragged its feet for five years in setting up incentives to reduce carbon dioxide emissions. It's time to act. We'd like to see serious tax breaks for energy efficiency and cleaner cars on a sliding scale for state auto registrations, based on emissions. Sliding scale state sales taxes that reward energy-efficient vehicles (including lawn mowers, boats, and planes) could help as well. We should also experiment with a carbon-trading system for CO₂ emissions that emulates the current market for pollution credits. And Detroit should hustle to develop an engine that does improve fuel efficiency. Surely the auto makers don't have to wait for Washington to force them again.

The science on global warming is improving. Now should be the time to establish workable incentives to lower greenhouse gases. Let's approach global warming clear-eyed.



Marcel Cockaerts, President
Kredietbank, Brussels

WHEN HE ASKED US IF WE COULD INSURE HIS BELGIAN BANK IN BANGKOK, WE SAID "ไม่มีปัญหา".

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BusinessWeek

1997

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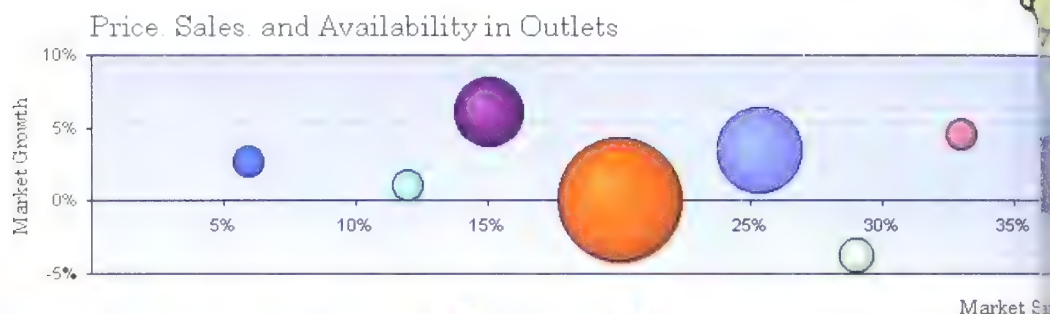
ALAN GREENSPAN'S BRAVE NEW WORLD

How the
Fed Chairman
Sees the
New Economy

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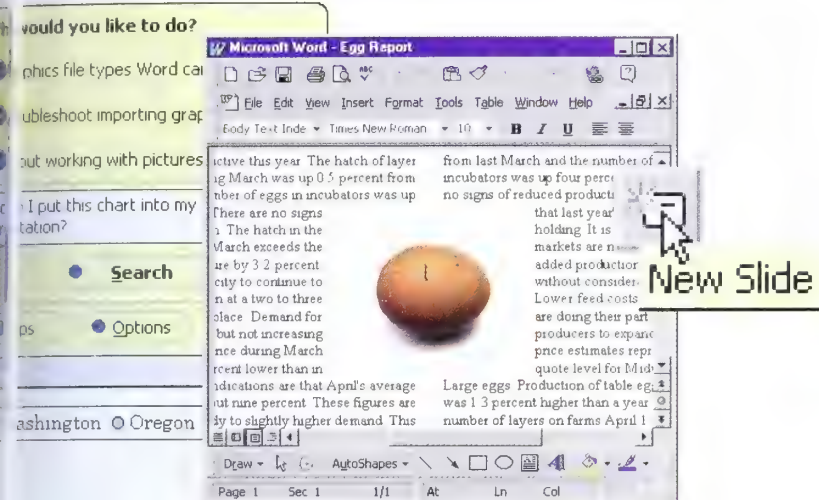
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PAGE 44



Microsoft Office 97/now/

be the
of your work



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ey go out into the world every day, your words and figures and e-mails. Introduce them to new
 Microsoft Office 97, and you can send them out with just that much more confident panache. First of all,
 Office 97 makes it easier to control the way text, shapes and even formats look with Formatting. You can
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 work. Send it out proudly, and try not to cry. For more information, visit us online.

COVER STORY

GREENSPAN'S NEW WORLD

His decision not to raise rates reflects his view that the financial markets now do much of the Fed's work *page 44*



BusinessWeek

JULY 14, 1997

Cover Story

44 GREENSPAN'S BRAVE NEW WORLD

After 10 years, the chairman's success and prestige are letting him take the Fed into uncharted territory—allowing faster growth and lower unemployment than were tolerated in the past. Why isn't he scared by faster growth? Because productivity gains are keeping inflation in check

48 THE ODD COUPLE

Bill Clinton on Greenspan, White House-Fed relations, and the economy

50 THE CHAIRMAN AS POLITICAL ANIMAL

Greenspan keeps tabs on Washington's pulse—even on the golf course

News: Analysis & Commentary

22 BILL GATES, THE CABLE GUY

His strategy: Come up with the technology to make Microsoft an indispensable player

24 SCARY TIMES @HOME

It could be one of the biggest IPO hits in years. But with Bill Gates knocking at the door, it's definitely @risk

25 AT&T: DIALING FOR DIRECTION

It's once more scrambling for a local-phone strategy

26 LOCAL-PHONE COMPANIES ON TRIAL

New entrants into service are suing to enforce competition. Baby Bells are in court, too

27 COMMENTARY

Never mind "corporate welfare" reform—this tax bill is loaded with breaks for business

28 WHAT MUST BIG TOBACCO DISCLOSE?

The proposed settlement may allow it to keep documents under wraps

29 COMMENTARY

The weird calculus of valuing a life

30 FORD ON THE FAST TRACK

The carmaker has moved from profit laggard to leader in just a year

32 BOEING AT YOUR SERVICE

After the merger, the giant could be maintaining 77% of all airliners

32 IT TAKES A TEAM TO OWN A TEAM

Major league sports clubs are getting too risky—and expensive—for individuals

34 IN BUSINESS THIS WEEK

International Business

36 SWITZERLAND

A chemistry tycoon raises Swiss passions against a fund to repay victims of Nazi terror

36 A TALK WITH CHRISTOPH BLOCH

"I think this is blackmail": The leader explains his position

38 COMMENTARY

Hong Kong: So far, Tung is making the right moves

39 MEXICO

Opposition pol Cárdenas likely to be the capital city's next mayor

41 INTERNATIONAL OUTLOOK

Central Europeans got membership in NATO, but they want to join the EU

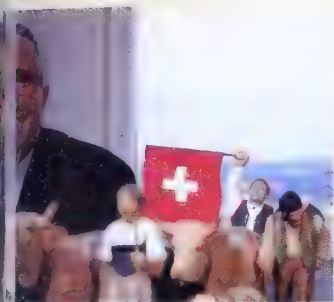
Economic Analysis

16 ECONOMIC VIEWPOINT

Dornbusch: The Asian juggernaut isn't really slowing down

18 ECONOMIC TRENDS

The jobs boom isn't nationwide, and health, board seats for retired Europeans' standard of living



SHOCKER

wants Switzerland to
n to Nazi funds page 36



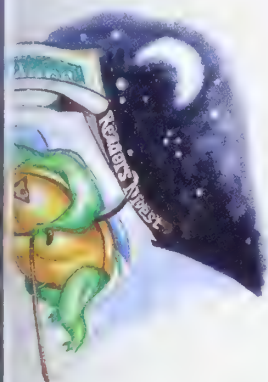
MAGIC FORMULA?

"Value at risk" tells investors exactly how big a gamble they're taking page 52



TELECOM TITAN

Bernard Ebbers tries to make WorldCom a global power page 65



DEADLY BUGS

How viruses may contribute to diseases page 70



GATES CALLING

His new digital technology could give cable television a jolt page 22

TORY
r's Digest isn't
sh machine it
o be page 62

BUSINESS OUTLOOK

e party's not over yet for this
nomy. Shoppers and manufacturers
re only resting in the second quarter

Government

WASHINGTON OUTLOOK

port from the heartland: The GOP
y have reason to worry

CRACKDOWN ON CORPORATE SPIES

e FBI gets serious about economic
ionage, but the law's weak penalties
y not be much of a deterrent

Finance

SETTING SMART ABOUT RISK

new method looks at how exposures
a portfolio can either amplify each
ier or cancel each other out

WAKING UP WEST COAST BANKING

ashington Mutual goes on a manic
ying binge in its quest to become a
ancial-services giant

ITIONS BANK AND MONTGOMERY

ill NationsBank's splurge pay off?
hat the match has going for it and
at could go wrong

56 'FLAT-FEE' BROKERAGE ACCOUNTS

They may not be so straightforward.
Be sure to read the fine print for
hidden costs and commissions

56 INSIDE WALL STREET

83 INVESTMENT FIGURES OF THE WEEK

The Corporation

62 PAIN AT READER'S DIGEST

With profits plunging, it's running up
against management tensions and
disillusioned investors

Information Processing

14 TECHNOLOGY & YOU

Laptop parts are becoming
interchangeable

64 CAN THIS MAN REV UP DIGITAL?

Marketing whiz Bruce Claffin has to fire
up sales for the whole DEC line—and
fast—as investors get restless

65 WORLD COM'S WORLD CONQUEST

Chief Bernard Ebbers has been on a
buying spree, and now the telecom is
No. 4—and growing

Science & Technology

67 DEVELOPMENTS TO WATCH

NASA's Pathfinder gets ready to touch
down on Mars, spaceships that come
back in one piece

70 IS CANCER CONTAGIOUS? NO, BUT...

Researchers find disturbing evidence
that viral and bacterial infections can
set the stage for a variety of diseases

Personal Business

78 TAKEOVERS: Riding the bank wave SMART MONEY: Hong Kong's handover

Features

4 UP FRONT

8 READERS REPORT

11 BOOKS

De Geus: *The Living Company*

81 BUSINESS WEEK INDEX

82 INDEX TO COMPANIES

84 EDITORIALS

Greenspan's bet on the new economy
Purge the tax code of politics

Up Front

EDITED BY LARRY LIGHT

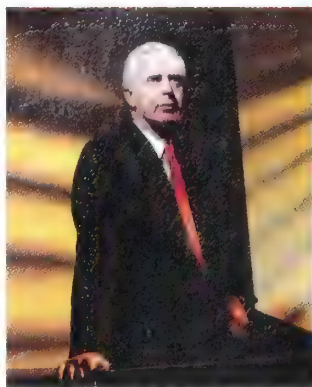
V.I.P. TREATMENT

A FIRST-CLASS ROW OVER LEVITT'S T&E

ARTHUR LEVITT JR., THE millionaire chairman of the Securities & Exchange Commission, may have to stop traveling in style. A House probe has forced him to skip luxury hotels and first-class plane seats.

Levitt's opulence didn't cost the taxpayer extra. For instance, the federal hotel-room max in San Francisco is \$99 daily. He said a \$99 room was not available, so the SEC comptroller granted him an upgrade to \$150. He applied the \$150 voucher toward the \$336-per-night Mandarin Oriental and paid the difference himself, say documents BUSINESS WEEK got under the Freedom of Information Act.

He did much the same thing on airlines, where federal officials must usually fly economy class. Levitt says he will no longer fly first-class



PILLOW MINTS are still O.K.

and has enacted rules making hotel and airline upgrades hard for SEC officials.

The Hill inquiry into \$100,000 in expenses for his SEC trips since October, 1994, may seem penny-ante. Especially since the SEC says it cost \$187,000 to answer questions from the House panel led by David McIntosh (R.-Ind.). Says a panel spokesman: "To us, it looks like Levitt is gaming the system." *Paula Dwyer*

STREET NEWS

EXPAT STOCK MAY GET HOMESICK

THE LOOSE FEDERAL REGS that govern overseas stock sales are about to get tight-



ened—but not as much as Wall Street fears. The Securities & Exchange Commission is under pressure from Congress and

others to rein in its controversial Regulation S, enacted in 1990 to make it easier for U.S. companies to raise capital abroad.

To critics, Reg S made things too easy. Overseas buy-

ers need wait only 40 days before they can sell these unregistered securities (often purchased at a discount of around 15%) back to Americans at full value. For small-cap stocks, that can mean substantial dilution, and thus price slides. So the SEC proposed boosting the waiting period to two years. This set off a roar of protest from Wall Street, which fears that such a long period would dampen enthusiasm for Reg S stocks abroad.

Result: SEC officials say they may trim the proposed two-year wait, though it's not clear to what. Wall Streeters say they can live with six months to a year. Lawyer Gary Wolfe, a partner at Seward & Kissel who represents overseas investors, wrote the SEC that six months would deter foreign quick-buck artists. □

TALK SHOW "For an athlete in the heat of battle, to loit is not new, but it isn't right."

—Boxer Mike Tyson, apologizing for biting Evander Holyfield ears in a Las Vegas title bout.

THE FEDS

HEAVY STATIC OVER THE NEXT FCC HEAD

AL GORE AND FRITZ HOLLINGS are facing off over Chairman Reed Hundt's successor at the Federal Communications Commission. There's long-simmering tension between the Vice-President and Hollings, the senior Democrat on the Senate Commerce Committee, over telecom policy. Gore is more free-market-oriented, while the South Carolinian wants the FCC to ensure that rural areas don't get short shrift.



AT ODDS: Gore and Hollings

Odds are that President Clinton will nominate Gore's choice, Kathleen Wallman, top staffer at the National Economic Council, Clintonites say. (Hundt was a Gore protégé, too.) Hollings and other Senate Democrats are pushing Washington lawyer Ralph

Everett, a former Hollings staffer.

Hollings is holding up confirmation of Joel Klein to be Justice's top trustb in hopes of landing Eve the job, say telecom indu sources. A Hollings aide "That's a ridiculous linka

Two of four vacant seats earmarked for Democrats, two the GOP. President Clinton's FCC General Counsel William J.

nard for a Dem spot in House Commerce Committee economist Harold Furchtgott Roth for a Republican. This month, Clintonites he will choose the new head and name Justice Dept lawyer Michael Powell, C Powell's son, for the ot GOP slot. *Catherine M*

THE LIST GUCCI GULF'S GOLDEN BOYS

The highest-paid honchos of interest groups hail from media and entertainment. Defending intellectual property is a big deal in Washington, whether against Chinese knockoffs or American



BERMAN

bluenoses. In 199 the last year for available stats, the music industry's Jason Berman edged ahead of Hollywood's Jack Valent the champ for three years.

TOP-PAID LOBBYING CHIEFS

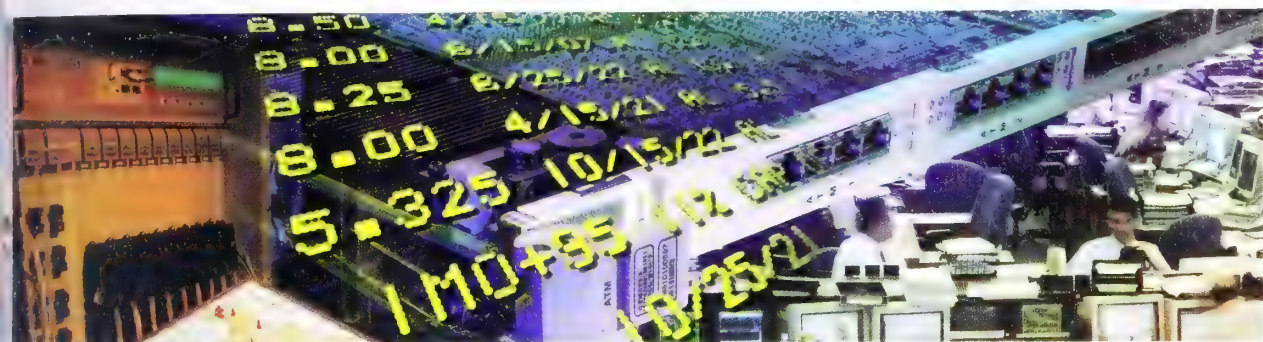
NAME	TRADE ASSOCIATION	PAY*
JASON BERMAN	RECORDING INDUSTRY ASSN.	\$1,087,84
JACK VALENTI	MOTION PICTURE ASSN.	921,37
EUGENE UPSHAW	NFL PLAYERS' ASSN.	894,10
FRANKLIN NUTTER	REINSURANCE ASSN.	714,31
DECKER ANSTROM	NATIONAL CABLE TELEVISION ASSN.	675,17
EDWIN HARPER**	ASSN. OF AMERICAN RAILROADS	674,75
WILLIS GRADISON	HEALTH INSURANCE ASSN.	666,11

*For 1995, as reported to Internal Revenue Service

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A HEAD-ON COLLISION OVER BIKE HELMETS



LIDS: Will they stay on?

MAKERS OF BICYCLE HELMETS are butting heads with *Consumer Reports*, which claims some helmets can come off in falls because of faulty buckles on the chin straps. In the June issue, the consumer's bible finds defects in 11 helmets (price range: \$30 to \$135), including Bell and Giro brands. They all use plastic buckles from ITW Nexus.

Sure, *Consumer Reports*

periodically gets flak from makers of products it pans. But now, helmet makers and ITW are marshaling independent laboratories and even the feds to pressure the monthly magazine to reverse itself—the first time in memory this has happened, the mag says.

The Snell Memorial Foundation, the leading tester for all kinds of helmets, attacks the story. Harborview Injury & Research Center, which unlike Snell does no work for the industry, examined 3,390 bike crashes and found that three buckles came apart. Meanwhile, the U.S. Consumer Product Safety Commission's tests find no Nexus buckle failures. Yet *Consumer Reports* stands by its story, saying many of the failed buckles came from a batch made last September. That points to broader quality-control problems that may recur, it believes. Roy Furchgott

RETRO FADS

LAVA LAMPS: AN ERUPTION

"MAKE LOVE NOT WAR," THEY said in the 1960s. But there's a war on over an icon of that time: the Lava Lite Lamp. Haggerty Enterprises, maker of the lamp, is suing a Taiwanese concern, Lipan Industrial, for trademark infringement. Haggerty, a privately held novelty maker, wants the U.S. International Trade Commission to stop Lipan from selling its similar products, the Rocket and Volcano Lamps. In a separate federal lawsuit, Haggerty also seeks an un-



THE ORIGINAL: Now imitated

specified amount in damages.

Baby boomers remember sitting around stoned and watching amoeba-like wax globules rising, falling, and dividing in a liquid-filled container. Lava Lamp—the popular name—has a trademark for its shape. Lipan says that its lamps are cylindrical and Haggerty's are conical.

Introduced in 1965, Lava Lamps had faded in popularity by the late 1970s. Recently, though, nostalgia has revived sales. Haggerty has expanded its manufacturing workforce from 8 in 1981 to 210 now, which is about the same level that it was back in the Flower Power era. Joshua Kaufman

DRAWN & QUARTERED



"SAME OLD STORY, SARGE... THEY BROKE INTO THE BANK AND THEN TUNNELED THEIR WAY INTO THE 'STARBUCKS'..."

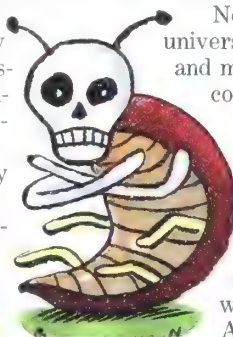
PRODUCT PEEK

NOT-SO-SAFE SEX FOR TERMITES

TERMITE CONTROL HAS LONG involved drilling holes for chemicals in your house and lawn. Yet lately, pesticide makers have found a more ecologically friendly way to dispatch the little wood-chomping devils: containers that emit a food scent. The tiny terrors, though, aren't trapped inside. They gobble up stuff called hexaflumuron, which prevents them from breeding, and eventually, they die out.

The first big test was at the Statue of Liberty. Termites infested the wood in the museum and other rooms

in the monument's pedes- Officials didn't want to holes in a historic site o- ject into the ground ch- cals that could have lea- into the harbor. So they- listed University of Flo- entomologist Nan-Yao Su- hexaflumuron.

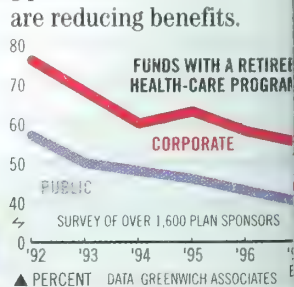


Now licensed by university to DowEl- and marketed as Se- con, the pro- stands to mal- sizable dent- the \$2 bil- termite man- FMC is sellin- similar dev- and one is on- way from Zer- Ag Products. D- Elanco's new pro- which costs \$2,000 for- typical house, has two co- urations: a wall-mounted- for inside and a spike to p- outside. Joshua Kaufm-

THE BIG PICTURE

FORCIBLE RETIREMENT FOR RETIREE HEALTH CARE

More and more retirees, both private- and public-sector are saying goodbye to health care paid for by their pensio- plans. Other plans are asking pensioners to share cost o-



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GUNMAKERS WON'T GET RICH OFF SALES TO WOMEN

As our children continue to pay the price for the proliferation of guns in this country, it is unseemly for the firearms industry to crow about profits from weapons sales to women. The supporting statistics quoted in the article "What do women want? Guns, actually" (Sports Business, June 2) are attributed to sources that are suspect at best. Research not beholden to the industry finds that the number of women gun owners has leveled off at 7% to 11% during the past 10 years.

The thousands of women we represent, and millions more like them, don't want a gun at all, not even a .357 Magnum, a .38 special, or a 9mm in a "rose-decorated" case with a pink pearl handle. That's because no amount of glamorizing can hide from them the cold, hard facts of this country's gun-violence epidemic.

Ann Reiss Lane, Chair
Susan Shaw, Executive Director
Women Against Gun Violence
Los Angeles

Betty Friedman
Women Against Gun Violence
New York

WHAT DIGITAL'S CEO REALLY EARNED

In "Seething shareholders" (News: Analysis & Commentary, June 9), you say that Digital Equipment Corp. director Thomas P. Gerrity voted "to pay [Robert B.] Palmer \$8.3 million in salary, bonus, and options last year." Here are the facts: For fiscal year 1996, which ended on June 28, 1996, Mr. Palmer earned a base salary of \$900,000, which has not increased in the past four years. Because the company did not achieve its profit targets for the year, neither he nor the other members of the executive team received a cash bonus.

Mr. Palmer did receive a grant of 185,000 stock options and an award of

8,000 shares of restricted common stock in August, 1996. This kind of incentive, consistent with the board of directors' belief that management compensation should be closely aligned with the interests of shareholders. Contrary to the impression you left with your readers, these options are valuable only if the company's stock price increases. The fact is that no compensation was earned by or paid to Mr. Palmer in 1996, respect to the options, and Mr. Palmer cannot immediately exercise any of the options, which vest over a three-year period.

Therefore, his actual compensation for 1996, including contributions to the company's 401(k) plan, was \$924,939—below the \$8.3 million you reported.

Charles B. Hollister
Vice-President for Communications
Digital Equipment Corporation
Maynard, MA

Editor's note: The figure cited—\$8,266,000—is a calculation of Robert B. Palmer's total compensation package for 1996, not 1995, as the story incorrectly stated. It was calculated by Graef Crystal Ball executive-compensation consultants. Crystal calculates that in 1996 Palmer was paid \$1,226,939 in salary and restricted stock. Stock options that Crystal values at \$3,498,000 were granted to Palmer shortly after the close of the 1996 fiscal year.

PUTTING BUSINESS THEORIES TO WORK

John A. Byrne's "Management theory—or fad of the month?" (News: Analysis & Commentary, June 23) makes an important point about a shortcoming in most companies: It is not easier to read a book, go to a management seminar, or preach an idea than it is to change an organization's practices.

Winston Churchill said of democracy: "It's a wonderful idea—what shame no one has tried it." The same could be said for reengineering, competencies, knowledge management, even total quality management. B

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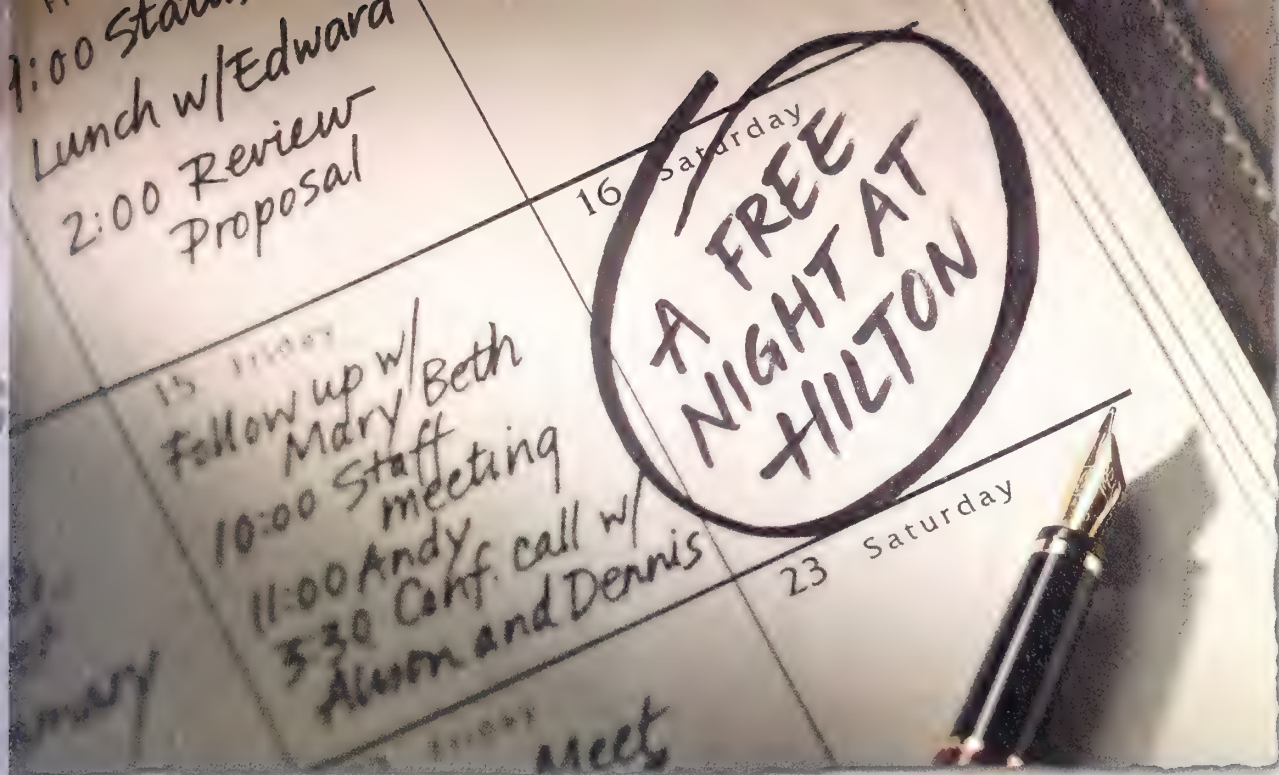
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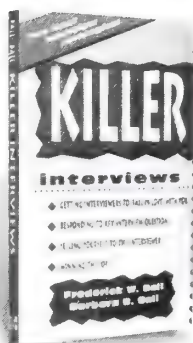


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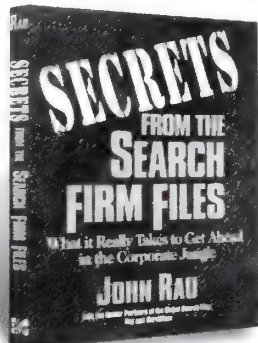
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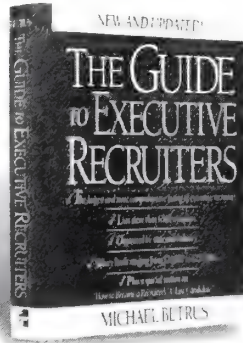
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Readers Report

ness process reengineering, for example, is a powerful idea that can work—have seen it generate new kinds of value, quality, and convenience for customers, save companies from going out of business, and save jobs.

Let's not blame the concepts. Let's place the blame where it really belongs on poorly informed managers.

James P. ...
Haas School of Business
University of California
Berkeley, CA

What organizations need is not a whole group of new, untested ideas. What American business needs is to learn how to listen to employees, understand how to motivate them, give them clear direction, and then get on the way.

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Tim Mulvaney
New York

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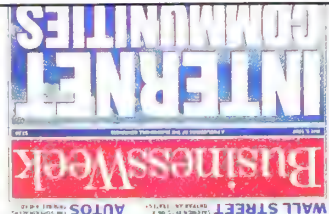
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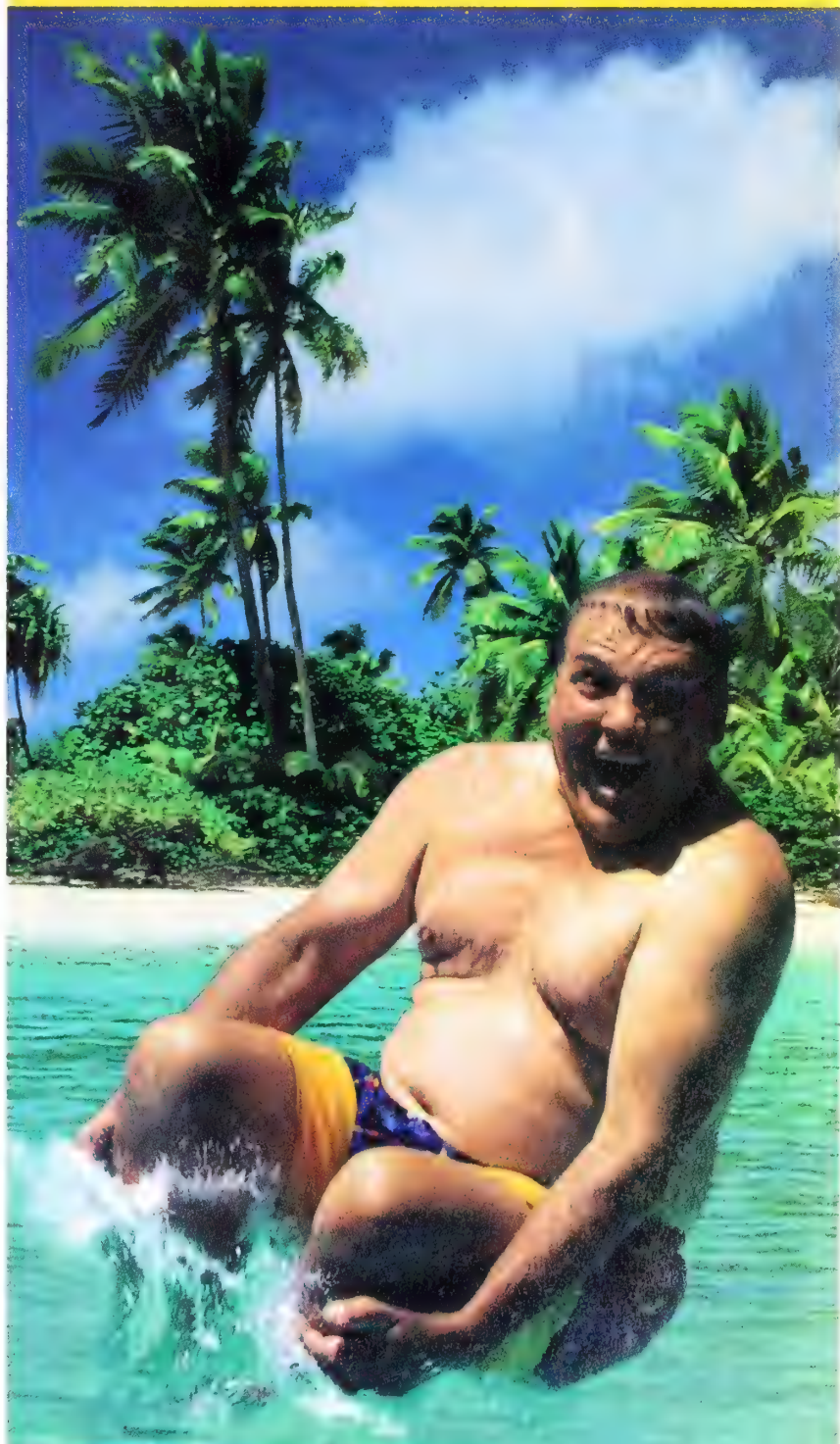
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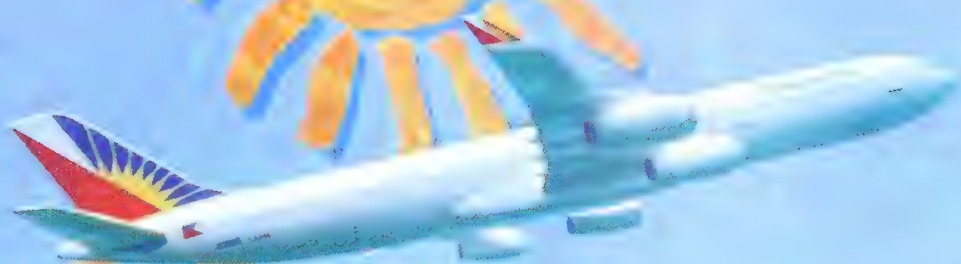




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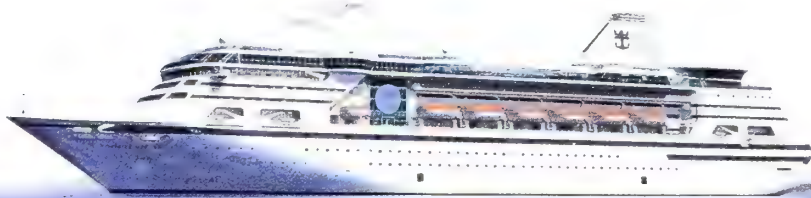
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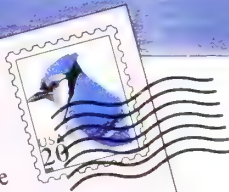


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LIVING COMPANY
Strategies for Survival in a Turbulent Business Environment
 by Arie de Geus
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THE BIOLOGY OF BUSINESS

Biology is turning up in the strangest places. Just consider Arie de Geus' *The Living Company*. With a light touch and an interesting variety of examples, de Geus employs biological metaphors in order to analyze corporate management. His anecdotal stories also draw upon experiences from his nearly 40-year career at Royal Dutch/Shell Group. Building on research into such long-lived companies as DuPont, South Korea's Sumitomo, and Unilever, de Geus distinguishes between "economic companies"—which are run as profit machines—and "living companies"—whose primary purpose is to survive and perpetuate themselves as ongoing communities. To explain the difference, de Geus draws from evolutionary theory, ecological psychology, animal-behavior studies, and even immunology—with examples ranging from titmouse behavior to potato cultivation in the Netherlands. Living companies, de Geus contends, improve their chances of survival by learning and adapting to their environments more quickly than do economic companies.

As a second-generation Shell man, de Geus begins by confessing that he long believed that most companies, including his own, would last forever. But he realizes that according to most surveys of corporate births and deaths, the average expectancy of a multinational is 40 to 60 years. One-third of the companies listed in the 1970 Fortune 500 had disappeared by 1993—acquired, merged, or broken to pieces. There are a few exceptions, such as Stora, which began more than 700 years ago as a copper mine in central Sweden, or Sumitomo, which had its origins in a copper-casting company founded in 1590. But de Geus says the wide gap between most companies' maximum possible life span and the average realization thereof represents huge

wasted potential—and devastated work lives and communities.

At Shell, an internal 1983 study of 27 long-lived companies grew out of an attempt to answer a key question: What would happen to Shell after its oil supplies ran out? It found that none of the long-lived companies it studied had allowed themselves to succumb to failure when a key resource was lost. Instead, they displayed a common ability to exploit such crises and turn them into new businesses. De Geus points to Sweden's Stora. In the 15th century, when Stora was just 270 years old, the king of Sweden threatened its independence. Stora responded by organizing into a powerful, militaristic guild. Through the subsequent centuries, it continually shifted its businesses—from copper to forestry to iron smelting, and eventually to paper, wood pulp, and chemicals. De Geus concludes that it survived by reacting rapidly to changes in its environment.

Moreover, de Geus believes, "companies die because their managers focus on the economic activity of producing goods and services, and they forget that their organizations' true nature is that of a community of humans." The Shell study found that the ability to return investment to shareholders seemed to have nothing to do with longevity. Profits were not a predictor or determinant of corporate health, but a symptom of it.

In his role as Shell's head of planning, de Geus began looking for a way to accelerate the company's ability to grasp environmental changes and adapt to them. So he turned to Allan Wilson, a zoologist and biochemist at the University of California at Berkeley. Wilson had developed a theory that species be-

havior, rather than environmental change alone, was the major driving force behind evolution. To illustrate this idea, Wilson used the example of the titmouse, a common songbird in Britain, which had learned to siphon cream from the milk bottles left outside doors by milkmen. After dairies began putting aluminum seals on the bottles, the birds figured out how to pierce them, then spread their skill from individuals to the species as a whole.

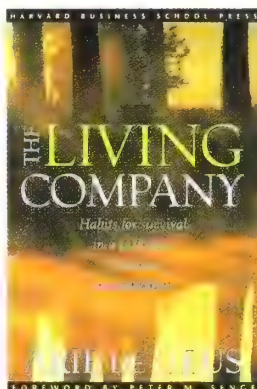
De Geus and Shell concluded that institutional learning requires "flocking"—bringing people together so that learning can be disseminated among them. That, in turn, requires an organization that's tolerant, giving employees a certain amount of freedom and space to experiment without fear of reprisal. De Geus tells a story about Chilean potatoes to illustrate the need for tolerance. Peasants in the Andes mountains traditionally grow a wide variety of potatoes. This doesn't yield as big a crop as planting

just one type of potato might, but if a natural disaster strikes, at least some of the potato strains are likely to survive. De Geus likens this to Lockheed's "skunk works," where innovators similarly face few demands that they be efficient. Such "tolerance towards the margin" is a key survival strategy, de Geus maintains.

At times, the author pushes the metaphor too far. Corporations have immune systems, he argues, that may be threatened by infections. Corporate hosts, for example, can develop either symbiotic or inimical relationships with trade unions. That's reasonable enough, but de Geus goes on to say that "acquisitions and mergers are infections. That is why the temperature goes up and the corporate body goes into resistance mode." Although he cites studies showing high M&A failure rates, de Geus' reasoning is simplistic, since there are instances when such so-called infections end up strengthening the whole. Overall, though, de Geus provides an interesting challenge to basic assumptions about the way companies work.

BY JULIA FLYNN

Flynn covers management issues from BUSINESS WEEK's London bureau.



DE GEUS SAYS LONG-LIVED COMPANIES SUCH AS DUPONT EVOLVE, JUST LIKE SPECIES



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BY STEPHEN H. WILDSTROM

EUREKA! LAPTOPS THAT SHARE PARTS

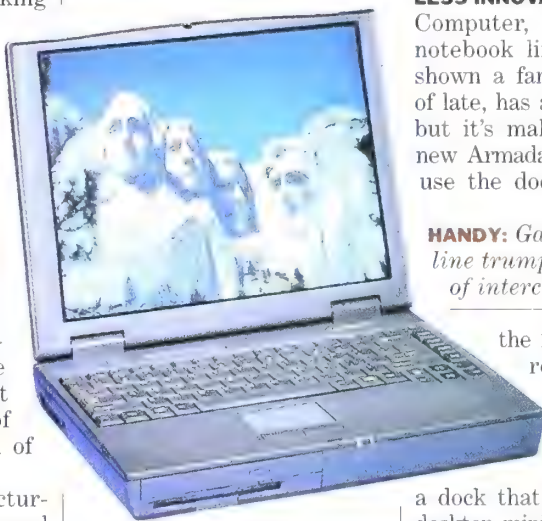
Machines are finally being designed that accept accessories from earlier models

In the past year, I've had perhaps two dozen laptops in my office for evaluation. Often, I'd like to use an accessory—a spare battery or an AC adapter left behind from a previous model. But these old parts almost never fit new notebooks because the design has changed.

This is more than an annoyance for lots of laptop buyers. For companies that have invested many thousands of dollars in docking stations and spare disks—or even the individual buyer who popped for a spare battery and connection to a car's electrical system—the inability to reuse components involves real money. Corporations, which often buy top-of-the-line notebooks for senior executives and entry-level machines for sales or service people in the field, want to minimize the cost of stocking a common pool of spare parts.

DOCKING EASE. Manufacturers are beginning to respond to the loud complaints from customers. More and more new laptops can use old accessories or share components with current models. "We are making a concerted effort to design our 1998 generation of products to have much greater commonality," says James Schwabe, senior vice-president at NEC Computer Systems.

Dell Computer got the trend rolling with its XPI laptops a couple years ago, but Gateway 2000, which is increasing its emphasis on corporate sales and trying to establish itself as a player in the notebook market, has taken the concept the furthest. With its new Solo laptops, the big direct-sales computer maker is promising customers interchangeable parts across its laptop line. One example is docking stations, into which you can slip a portable computer to use a corporate network or other features. Gateway designed a \$599 docking station with multi-



HANDY: Gateway's Solo line trumpets the concept of interchangeability

media capabilities and a \$199 minidock for its under-\$2,000 Solo 2100, but the \$6,000 top-of-the-line Solo 9100XL can use the stations, too. "We can do standards across lines and across generations," says Bob Burnett, director of mobile systems for Gateway. "It's cheaper and easier for customers."

It can be hard for manu-

facturers to simplify their customers' lives. The switch from 486 to Pentium processors required major laptop redesigns to deal with increased power and cooling requirements. Now, Intel wants laptop makers to use its new Mobile Module (MMO) Pentium package. This standardized module, which the Gateway Solos use, could make common designs easier in the future, but it will mean more incompatibilities between new designs and existing machines. It's tough to share disk drives, batteries, and docks between normal 2-inch-thick laptops and the new ultrathin models.

Another factor confounding common designs is something laptop makers don't much like to talk about: Many of them farm out the manufacturing—and sometimes the designing of some models—to third parties that have their own way of doing things.

LESS INNOVATION. Compaq Computer, whose various notebook lines have barely shown a family resemblance of late, has a long way to go, but it's making a start. Its new Armada 7700 models can use the docking stations of

the LTE5000 units they replace, and special plastic inserts allow all new Compaq laptops to share a dock that turns them into desktop minitowers. The company is promising greater reusability of components in future models.

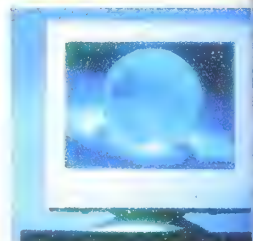
One disadvantage of standardized components may be a bit less innovation in the design of new models. However, that is a small price for buyers, who now are stuck having to toss out accessories whenever they upgrade their laptops.

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When you first look at the PanaFlat PF-17 monitor from Panasonic (800 742-8086), you will swear the screen is curved inward. Our eyes are so used to seeing monitors



with bulging screens that don't realize the \$999 Panasonic is really dead flat. The biggest advantage with the new monitor is distortion-free images. Its flat configuration also gives it the ability to use every bit of the 15.7-inch diagonal viewing area. Panasonic rates the flat, high-resolution picture tube, made by parent company Matsushita, at up to 1600 by 1280 pixels. But most people will probably be happiest at 1024 by 768, which provides comfortably sized texts and icons.

SOFTWARE

A MORE PERFECT SUITE

Corel WordPerfect Suite 7, launched last year, was an impressive collection of applications but lacked the slick integration offered by rivals from Microsoft and Lotus. The new version 8 for Windows 95 and NT has a much stronger sense of a common look and feel for key elements: WordPerfect, the Quattro Pro spreadsheet, Corel Presentations, and CorelCENTRAL information manager. The suite costs \$395, though people who use any Corel, Lotus, or Microsoft office suite can get a \$179 upgrade.

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U S W E B

BY RUDI DORNBUSCH

THE ASIAN JUGGERNAUT ISN'T REALLY SLOWING DOWN



DYNAMISM
True, the old tigers have slipped, but new ones are roaring—and big productivity hikes may be under way

The Thai baht is on the ropes, there is a big question mark over Hong Kong's future, Korea is the pits, and nobody is quite sure whether Malaysia and Indonesia will soon join the list of wounded tigers. The glow of Singapore's propaganda about the Asian economic model without the weakness of Western democracy is fading. How much of this malaise is temporary, and how much is basic and lasting—leading to poorer performance?

Two years ago, Massachusetts Institute of Technology economist Paul R. Krugman created an uproar when he proclaimed that Asia's stunning growth had two problems. He said progress was much like Russian growth in the past: It was won by massive, often wasteful capital accumulation rather than productivity growth. Looking ahead, he said growth prospects would decline because hard work, saving, and scanty consumption couldn't last. Even in Asia, people ultimately want a better life, and that means more consumption, less saving, less investment, and hence lower economic growth. No sooner had the prediction been made than the facts obliged. Many, if not all, of the Asian economies started running into one kind of trouble or another. The forecast was brilliant, but Krugman is too pessimistic.

DEFERRED GRATIFICATION. There are two sources of growth: increased capital per worker and increased productivity. The trouble with capital accumulation is that someone has to do the saving. If capital accumulation gets a country ahead, it has to be paid for by postponing consumption. But increased productivity gets a country ahead without the sacrifice of consumption.

While the received wisdom on Asian growth credits capital accumulation, new research shows that growing productivity is playing a larger role. Barry Bosworth and Susan Collins at the Brookings Institution show that productivity growth in the past decade was far higher than in the preceding one. This view is less pessimistic than Krugman's and suggests the Asian growth model is changing.

The rise in productivity, however, is so far not sufficient to keep Asia growing at its previous high levels. Between 1979 and 1988, growth in the Asian tiger economies was 8% a year, but from 1989 to 1996 it was 6.9%. Some slowdown is clearly under way for the

oldest tigers. But the new tigers—Malaysia, Vietnam, China—more than compensated for the shortfall. In these countries, economic growth over the same periods advanced 6.7% to 8%. These patterns change only gradually. Thus it is safe to argue that emerging Asia still has and will continue to have extraordinary dynamism. Over the past decades, the standard of living has more than doubled. And it will probably do so again in the next two.

READY TO POUNCE. But in the short run, politics and financial factors will play a role. That is obvious in Korea and Thailand, where stocks have collapsed, policy disarray is pervasive, and speculators are just waiting to pounce. In finance, we have a transition from highly regulated systems to a free-for-all. The typical pattern is for banks, freed of regulation, to borrow offshore at low rates and lend for real estate transactions without restraint. The next step is the inevitable bursting of the property bubble, which then causes a banking crisis. That happened in the Nordic countries, and Japan, and is now under way in Asia.

The other complicating factor is the transition from a strongly statist and regimented economy to the free market. That is new in Asia and comes as something of a shock. Consider Korea. The country has worked hard to come exactly like Japan economically. The bad news: It succeeded. As in Japan (or Korea), everything goes like clockwork. The bad news: With heavy regimentation by government and corporate bureaucracies, creativity is stifled. Even today, the Korean government is meddling in the economy in a way that is far more extreme than even in France.

The spread of democracy in Asia is changing the workplace—ending an era of low wages trailed productivity, labor was paid beyond belief, and “strikes” took place only after long work hours. There is turmoil involved in shifting from centralized to market economies, and Joseph Schumpeter's creative destruction is well under way in Asia. Close things look messy, and financial markets mistake the transition pains for major problems with stability and economic growth. If you believe in markets, this transition is ultimately good news. Beyond strikes and bankruptcies, the free-enterprise economy is picking up the productivity gains that will keep Asia growing.

I FIND THE GREAT THING IN THIS WORLD

IS NOT SO MUCH WHERE WE STAND, AS IN WHAT DIRECTION WE ARE MOVING. - Oliver Wendell Holmes, Jr.



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T A H O E

LIKE A ROCK

BY GENE KORETZ

THIS JOBS BOOM ISN'T NATIONWIDE

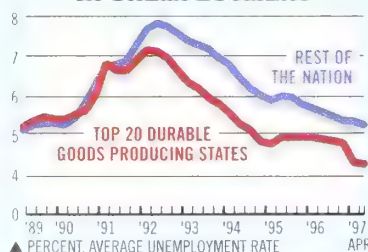
So the Fed can just tap the brakes

With U.S. unemployment at its lowest level in 23 years, many observers think it's only a question of time before fears of wage cost escalation prompt the Federal Reserve to hit the monetary brakes. Economist James Paulsen of Norwest Investment Management, however, warns that the aggregate unemployment rate gives a false picture of overall labor market tightness.

"We are really looking at a two-tiered labor market," he says. "One tier involves the durable-goods segments of the economy, including housing, autos, and capital spending, which have accounted for most of the growth in the current expansion. The other much larger tier reflects the slow growing services and government sectors."

To prove his point, Paulsen compares the 20 states with the greatest dependence on durables output with the other

A TWO-TIERED DECLINE IN UNEMPLOYMENT



DATA: NORWEST INVESTMENT MANAGEMENT

30 states. At the peak of the last business cycle in 1989, he notes, both groups had similar unemployment rates (chart). But in the seventh year of the current upturn, the average jobless rate in the top 20 durables producers (led by several Midwestern states) is just 4.27%. By contrast, the rate in the rest of the nation, which accounts for two-thirds of the labor force, is around 5.25%.

In sum, says Paulsen, labor markets are only "hot and tight" in a minority of states that depend heavily on industrial activity and construction, a situation that calls for only very moderate increases in monetary restraint. Indeed, because business investment, housing, and consumer purchases of big-ticket items are

all interest-sensitive activities, he believes that a small upward movement in interest rates would ease labor market tightness a lot more quickly than in the past.

"If the Fed can avoid overkill when tapping on the monetary brakes," he says, "the economy may benefit from both more measured growth and more migration to regions with labor shortages."

GROWING OLD, GRACEFULLY

Chronic disability has been waning

Judging by health patterns prevailing in 1982, the ranks of seriously disabled Americans aged 65 and older should have jumped by 2 million between 1982 and 1994, a period in which the elderly population rose by 7.4 million. Instead, report researchers at Duke University's Center for Demographic Studies, the number of disabled elderly increased by just 800,000.

In essence, a smaller proportion of the elderly population suffers from serious disabilities today than was the case 15 years ago, a trend that appears to reflect both continued medical advances and the rising educational attainment of those entering their golden years. Better-educated people, notes *Forecast*, a monthly demographics newsletter, tend to smoke less, exercise more, and generally behave in ways that reduce disability late in life.

If the health of oldsters continues to improve at the pace achieved from 1982 to 1994, the Duke team estimates that the number of disabled senior citizens will actually drop around 100,000 by 2004.

TRULY GOLDEN YEARS FOR EX-CEOs

Sitting on boards can pay off big

Is there a rewarding life for chief executives after retirement? The answer appears to be yes, according to a study by James A. Brickley of the University of Rochester and Jeffrey L. Coles and James S. Linck of Arizona State University. Analyzing a sample of CEOs from major corporations who left office between 1988 and 1992, they found that nearly 90% sat on at least one corporate board after retiring and nearly two-thirds held at least two seats.

What's more, board service can be

quite lucrative, producing an average \$44,000 a year per corporation seat. One retired CEO in the study—All Jacobson, former head of 3M—he fewer than nine seats on different corporate boards and earned an estimated \$597,900 a year for board service retainers, meeting fees, stock awards and option grants.

Getting a plum board position is more than having cronies in high places. A CEO who produced high stock returns and income on assets in his final year was more likely to wind up as a director of his company after retiring than one who didn't do as well, the study found. And those with good track records were also more likely to get outside directorships. Thus, retiring CEOs have a substantial financial incentive to do well in their years of service.

IF EUROPEANS WORKED MORE.

They'd reach U.S. living standards

If production per hour worked were the sole determinant of living standards, several European countries would now be on a par with the U.S., observes a new Conference Board report on the global economy. As it is, although productivity in Belgium, France, Germany, and the Netherlands is now above U.S. levels, the standard of living—as measured by per capita output—is about 20% higher in the U.S. than in other major industrial countries (table).

A reason, note the study's authors, that Europeans simply don't work as much as Americans. Not only are fewer Europeans of working age active in the labor force but unemployment in Europe is significantly higher than in the U.S., and Europeans who are employed put in shorter work weeks and enjoy longer vacations.

By contrast, although Japan's overall labor productivity is below that of Canada and Europe, its living standards are higher. That's because it has far lower unemployment and its workers put in substantially longer hours.

A G7 ECONOMIC SCORECARD

PERCENT OF U.S. LEVEL 1995

GDP PER HOUR CAPACITY

BRITAIN	84
CANADA	85
FRANCE	102
GERMANY*	101
ITALY	90
JAPAN	68
U.S.	100

*West Germany
DATA: CONFERENCE BOARD

JAMES C. COOPER & KATHLEEN MADIGAN

THE BEAT MAY PICK UP AS THE GOOD TIMES ROLL ON

Shoppers and manufacturers were just resting in the second quarter

U.S. ECONOMY

The economic data continue to depict the second quarter in a lull that comes in any extended party. After leaving the dance floor for two quarters, consumers are mostly content to sit out the spring months. Homebuilders and manufacturers, meanwhile, were still going in the second period, but to a slower beat.

At the same time, rising inflation, always an unwanted guest, remains a no-show. And as a result, the Federal Reserve, which threatened to take away the punch bowl when it hiked interest rates in March, now is content to let the economy rock on.

INDUSTRY STRENGTH WITH NO INFLATION



'96 JUNE '97
PERCENT REPORTING IMPROVEMENT
PRICE INCREASES
DATA: NATIONAL ASSOCIATION OF
PURCHASING MANAGERS

first quarter, even as producers are encountering little inflation (chart).

Most important, the major consumer fundamentals, growth and income gains, look as supportive as a pair of comfortable shoes. So expect consumers to be out on the parquet this summer, with goods producers picking up their step as well.

The chaperones at the Fed, of course, are very much concerned with the outlook. The first order of business at the July 1 and 2 policy meeting was the economic outlook for the rest of the year and into 1998—the forecast that will be delivered to Congress by Fed Chairman Alan Greenspan later in July. As widely expected, the Fed left short-term interest rates unchanged—implying that Greenspan & Co. expect growth to remain modest with no threat from inflationary pressures.

NATION'S PURCHASING MANAGERS might all half agree with that assessment. The National Association of Purchasing Management's overall index of industrial activity slipped to 55.7% in June, from 56.1% in May. However, the index remains well above the 50% mark, a sign that the factory sector is ex-

panding soundly. The NAPM said that its index so far this year is consistent with real gross domestic product growth of 3.7% for 1997.

The purchasers' report also showed no inflation. The index of prices paid dropped to 48.1% in June, from 48.4% in May. A reading below 50% means that prices are generally declining. And businesses had to wait just a little less time for deliveries. The vendor-delivery index fell to 54.6%, from 55.2%—a sign that production bottlenecks are not causing shortages that can lead to price increases.

The readings on production, new orders, and order backlogs showed growth, but at a slower pace in June than in May, while export orders were unchanged at a high level. Despite slipping in June, both total new orders and the order backlog in the second quarter were at their highest levels in nearly three years. This pent-up demand is why producers will keep lifting output in the second half.

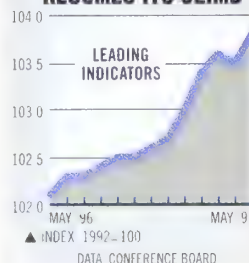
The Commerce Dept.'s report on the factory sector in May showed that orders fell 0.7%, after April's 1.4% rise. The April and May average of bookings remained above the first-quarter level. May inventories rose 0.4%, partly reflecting a 1% drop in shipments, as May output increased 0.5%. However, the fall in shipments was largely the result of a sharp drop in autos, at least partly related to strike activity.

The Conference Board's index of leading indicators also projects a pickup in activity. After dipping 0.1% in April, the index came back with a 0.3% rise in May (chart). The surging stock market, a smaller number of jobless claims, longer delivery times, and rising consumer expectations all contributed to the May increase.

CONSUMER OPTIMISM over the economy in general and the job market in particular is why households are getting back into the swing of things. And until consumer fundamentals start to falter, the outlook for consumer spending will remain bright.

In fact, consumers looked livelier in May. Their inflation-adjusted spending rose a solid 0.4%, after making little headway in the previous three months. Pur-

THE LEADING INDEX RESUMES ITS CLIMB



chases of durable goods and services led the May gain. And retail surveys for June sales suggest that store purchases rebounded last month. The weekly roundup by LJR Redbook Research reports a strong 1.7% increase in sales at department and discount stores.

For the second quarter, real consumer spending probably grew at an annual rate of only 1% to 1.5%. And since household purchases account for two-thirds of the economy, that weak performance means that total GDP growth struggled to reach 2% last quarter.

However, income growth is still solid. Real disposable income rose 0.3% in May, and for the second quarter, earnings are on track to rise at a 3% annual pace, about twice as fast as the pace expected for real consumer spending. That extra income, coupled with the wealth gains from the stock market, will provide the financial resources for spending increases.

ONE AREA WHERE CONSUMERS have not pulled back is housing. New single-family home sales surprised most analysts by going up 7.1% in May, to an annual rate of 825,000. Existing home sales also rose by 4.4%, to 4.24 million, the highest sales rate in a year.

Purchases of new and existing homes so far in the second quarter are running ahead of their first-quarter pace (chart). Home buying is unlikely to continue to post big advances in the second half, but that doesn't mean housing won't help economic growth. First of

all, builders had only a 4.1 months' supply of unstarted homes in May, the tiniest inventory in 26 years. So housing starts, which have fallen for three consecutive months, could pick up in the summer. Second, new homes will have to be furnished, spurring sales of furnishings, carpeting, and other home-related goods.

Housing's resilience isn't hard to explain. Consumer confidence in the future is at a nine-year high, pumped up by healthy income gains and good job growth. Also, despite the gyrations of the bond market, mortgage rates remain below 8%, and through mid-June, the four-week average of mortgage applications to buy a home was on the rise. Moreover, shareholders may be using some of their equity gains to purchase a home.

For now, the Fed seems willing to wait and see how all this plays out. Heading into the third quarter, though, the news on manufacturing, housing, and personal income argue that the economy will perk up this summer. The fear is that the festivities could attract gate-crashers, such as inflation. If so, the Fed will have little choice but to calm the party with another hike in interest rates.

HOUSING STILL SHOWS NO SIGN OF FATIGUE



FRANCE

JOSPIN IS RIDING A WEAK WAVE

New Socialist Prime Minister Lionel Jospin is taking over a French economy that is improving after last year's disappointing 1.5% growth rate. However, the 2.5% pace expected for this year will not be potent enough to dent France's record 12.5% jobless rate until later this year, nor will it allow the government to meet the Maastricht Treaty deficit target of 3% of gross domestic product.

After a weak 0.2% gain in first-quarter real GDP, second-quarter growth is shaping up to be strong. Manufacturing output, up a broad 1.1% in April, is in a sharp upturn since January (chart), and construction is recovering nicely after a bad

winter. Although business confidence in the future declined in June, which probably reflected new political uncertainty after the elections, companies say current conditions are improving, led by

robust foreign demand. Indeed, the April trade surplus hit a record, powered by surging exports.

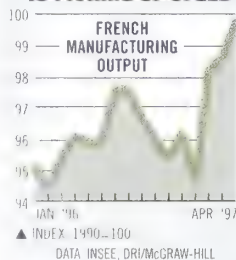
However, the export-driven recovery is not yet energizing the domestic economy. Household spending for factory goods dropped 1.1% in May,

led by falling car sales, and consumer confidence remains weak. Right now, policy uncertainty, especially about new taxes, is restraining spending by consumers and businesses, but the trends for

each are starting to move up. Upcoming growth will be fueled by a weak French franc, less drag from fiscal restraint, and very low interest rates, the result of a 40-year-low inflation rate of 0.9%.

Jospin is sounding a bit more pragmatic compared with his pre-election rhetoric. His objectives for growth and jobs appear more balanced with his commitment to an on-time euro, and he admits that public finances are a problem. He also has put forth a not-so-aggressive 4% hike in the minimum wage, and Cabinet ministers are talking about cutting labor costs. The July Audit of State Finances will show a 1997 deficit of at least 3.5% of GDP, which may have Jospin backtracking on some election promises. He knows the financial markets will accept the 3.5% ratio only if 1998 looks like 3%.

FACTORY ACTIVITY IS PICKING UP SPEED



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Transactions in the Age of the Consumer



BILL GATES, THE CABLE GUY

Will his technology for digital TV become the standard?

When Microsoft Corp. invested \$1 billion in Comcast Corp. last month, it looked like the best thing to happen to the cable industry in years. For its cash, Microsoft got an agreement for up to 11.5% of Comcast, the fourth-largest cable company. But the vote of confidence from the mighty William H. Gates III immediately drove up the value of cable stocks by several billion dollars.

Cable executives—and not just Comcast President Brian L. Roberts—seemed almost awestruck by Gates. And why not? With a few comments to the media, the software billionaire quickly turned the idea of upgrading cable systems into the “broadband” pathway for high-speed data to the home from a distant dream into a bona fide high-tech vision.

But Gates wasn't simply out to make some new friends among America's cable moguls. Having established a measure of goodwill with his \$1 billion, Gates is asking the cable industry for a little favor in return. He'd like cable companies to let him design a new generation of set-top boxes for digital TV. His design includes a cable modem for high-speed data communications, enabling consumers to cruise the World Wide Web on the TV. Gates' come-on: His design would cost about half what technology now hitting the market costs, thus making it a far easier sell.

NEW PLATFORM. If the cable moguls bite, Gates could be adding a new domain to the Microsoft empire. The boxes would use Microsoft software, including the Windows CE operating system, and that would establish Microsoft technology as the standard for all sorts of consumer programming and services to be delivered over digital TV and the Internet. This would represent an all-new technology “platform”—

like the PC itself. Microsoft “is putting itself in position, right in the middle, writing the software that controls all that,” says an executive familiar with Microsoft's proposal. Gates wants “to make sure the cable guys do not develop an independent base without him to do this.”

Gates is moving swiftly to seal a deal. He has been meeting every few weeks with the top executives of the big companies that control Cable Labs, the cable-TV industry's research and development consortium. The next meeting, on July 7 in New York, will likely include Gates, Tele-Communications Inc.'s John Malone, Comcast's

industrywide standard. “Bill Gates is a tremendously innovative mind, his concept has tremendous value. It would be [cable's] R&D arm,” says Rogers, whose cable system is Canada's largest. “There's a 50/50 chance we'll be able to come together on an economic model.” By late September, he reckons, the deal should be done or abandoned.

The possible hurdles include tough negotiations on financial terms—such as how much of a royalty Microsoft would collect on each box. Also, assuming as Gates' product may be, it's not the only design out there. Netscape Communications

Charming His Way In

Microsoft's set-top box would:

- ▶ Combine the functions of a cable modem and digital set-top box in one device.
- ▶ Be cheaper. Gates says he can design a box that consumers would buy for about \$300, compared with current cable modems that run \$200 to \$300 and settop boxes at \$450.
- ▶ Use Microsoft software, including the Windows CE operating system designed for handheld computers and other consumer devices.
- ▶ Enable Gates to set all the standards and specifications for the device that will link both PCs and TVs to information providers.

Roberts, Cox Communications' James Robbins, and Rogers Communications' Edward Rogers—all key participants at earlier meetings.

Gates's offer may be too enticing for the cable companies to pass up. On their own, the financially strapped companies have been unable to bring forth the gizmos needed to make Internet TV a reality. Indeed, they have not even been able to settle on their own

communications Corp. and now owned by Microsoft rival Oracle Corp., is working on similar technology. Its software for set-top boxes is being evaluated by Cable Labs.

There's another factor. While cable executives are intrigued by the prospect of a tidy ending to their technological quest, some are fearful of handing Gates a standard that will let him exert the same degree of control over



er fates that he has over PC makers. Everyone is a little wary, knowing how powerful Microsoft is," says one executive. "This is all about control of the TV set, just the way Gates control [of the PC]. But if Gates come up with a less-expensive converter box for the digital world, I'd be very not to look at it." The box Gates is hoping to devise is different from the limited-capability

digital set-top boxes and cable modems that cable companies have started to offer—usually in limited test markets. Combined, the cable modem and set-top box setups now available cost around \$700. Gates' box would cost only \$300. Powered by Windows CE, a Microsoft operating system designed for consumer devices, it will be more like a PC. Microsoft will also offer Windows NT for running the "headend"

systems at the cable companies.

If Microsoft makes nothing on the boxes themselves, it could still come out ahead. By pumping out millions of set-top boxes with Windows CE, the cable companies will make that software the standard programming interface across digital-TV land. Content developers from game designers to home-shopping companies would then write programs for the new platform. And Microsoft would be in there, too, adding applications programs and content of its own—to sell to tens of millions of consumers.

TAKEOVER TALK. Indeed, the current negotiations with the cable guys is part of Microsoft's broader push into media and content. "Microsoft has invested in cable programming through NBC, cable operators through Comcast, and a device to bring the Internet and cable together through WebTV," says NBC Cable President Tom Rogers. Microsoft's "next natural step is to devise the guts of the digital set-top box."

Gates' ambitions in media might, in fact, complicate his cable dealings. The software mogul's forays are already producing fear and loathing—and wild rumors. On July 1, the *New York Post* had Gates mulling an acquisition of CBS. Shares of CBS's parent, Westinghouse Electric Corp., jumped—despite denials by Microsoft and CBS that a deal was under way.

Rival software billionaire Lawrence J. Ellison, chairman of Oracle, predicts that Gates' push into content will make Microsoft a less desirable "technology partner for cable companies than Navio." "We're not going to go into the content business, competing with ABC," says Ellison. Gates, he says, "wants to be Barry Diller; he wants it all."

But fear of Gates isn't likely to scuttle Microsoft's cable campaign. Cable companies have struggled for years to expand their reach beyond ordinary TV programming. They made deals with telephone companies, invested in all

sorts of interactive-TV ventures—and lost hundreds of millions of dollars and vast amounts of credibility. Today, big projects like Time Warner's Full Service Network are shuttered. Cable companies are quietly launching cable-modem services, like Time Warner's RoadRunner, U S West's Media One Express, and @Home. But there is no nationwide system, no standard that

will inspire new programming and attract a mass market. Microsoft is offering not only a simple technology fix, but the proven ability to create a standard and get the market to follow it.

Given that, many cable executives may feel it would be foolish not to follow Gates. "We're dealing with the smartest man in America," says Rogers, the Canadian cable executive.

When Gates puts on his show for cable guys, he adds, "we all look at each other, wondering if we're missing something." As they choose their path to the digital future, cable executives would do well to keep that question in mind.

By Elizabeth Lesly and Amy Cosentino in New York, with Ron Grover in Angeles

NOT @HOME ALONE: BILL COMES KNOCKING

In the 28 months since it was founded, @Home has burned through \$38 million. It expects to spend \$30 million more by yearend as it attempts to build a high-speed "backbone" for delivering Internet content over cable-television systems. So far, there are only 11,000 customers in the world paying for its service. In the quarter ended Mar. 30, @Home lost nearly \$11 million on just \$806,000 in revenues, and it expects to continue losing money for the foreseeable future.

So why is the company's imminent initial public offering expected to be one of the hottest high-tech IPOs in years? It could be the luminaries behind the venture: media scion William R. Hearst III, venture-capitalist John Doerr, Netscape Communications Chief Executive James Barksdale, and high-tech companies such as Sun Microsystems, Motorola, and Bay Networks. Five cable companies, including Tele-Communications, Cox, and Comcast, together hold 70%, pre-IPO.

ACED OUT. Those are big drawing cards for the 8 million-share offering, which is expected to bring in at least \$58 million, giving the company a market value of about \$600 million. And there's buzz on Wall Street that the valuation could go as high as \$1 billion. "The valuation is ahead of itself, based on the fundamentals," says Geoffrey Y. Yang, a partner at Institutional Venture Partners. "It's being priced on what the future can bring."

But Yang and other Silicon Valley investors believe @Home's future will justify the big valuation—thanks to its most important asset: Exclusive

contracts with its cable backers to use the startup's technology to provide "broadband" communications to the 44 million homes their wires reach. If millions of consumers sign up for high-speed Internet access via cable modems, @Home stands to make a fortune by providing the basic connections as well as online content. It will share monthly fees and advertising

Netscape software, rather than Microsoft's, for browsing the Internet.

Now Gates is stepping up his campaign. His \$1 billion stake in Comcast, which owns 14% of @Home, gives him a small stake. And, as the @Home prospectus reveals, Microsoft can force Comcast to terminate its exclusive relationship with @Home after June 4, 1999, and sell its

@ RISK?

For William Hearst III and his partners, Bill Gates' entry changes all the rules

@Home shares back to the company.

Meanwhile, Gates is lobbying CableLabs, an industry research and development group, to adopt his next-generation cable box design. His interest is in establishing a Microsoft-friendly standard.

How Gates proceeds will be determined in large part by the cable companies. @Home's cable partners could adopt Gates' new set-top box and software. Or they could abandon the startup altogether. That's not likely, given their investment in the company. More importantly, there's a growing consensus among cable executives that it may be safer to work with Gates than to fight him—it's possible, sources say, that Gates could even take a stake in @Home. Says Graig Mundie, senior vice-president of Microsoft's consumer platform division: "There's no reason this can't be a symbiotic relationship." That's fine as long as @Home doesn't mind being the pilot fish to Microsoft's shark.

By Amy Cortese in New York, with bureau reports



revenues with the cable companies.

For now, the @Home service is simply a fast Internet system for personal computers. But eventually, @Home seeks a bigger audience by delivering the Internet—and other new digital programming—to TVs, too. The company has deals with dozens of content developers, including CNN and the Discovery Channel.

All this has such enormous potential that Microsoft Chairman William H. Gates III has been fuming that he still has not nailed down a piece of the action. The software mogul has complained to cable companies that he has been locked out of the @Home cabal. The company's directors include such Microsoft foes as Doerr and Barksdale, and it has adopted

CALLING FOR DIRECTION

AT&T scrambles once more for a local-phone strategy

The collapse of AT&T Chairman Robert E. Allen's breathtaking plan to merge with Baby Bell SBC Communications Inc. is more than just an embarrassing gaffe. Sure, Allen's rare public spat with Federal Communications Commission Chairman Ed E. Hundt—a bitter exchange in news media over the ramifications of a deal that AT&T never officially acknowledged—leaves AT&T image-making overtime to repair the damage. But the real harm is that AT&T faces more scrambling for a strategy

near where they wanted to be or where analysts expected them to be."

So, what next? Sources close to the company say that, despite the SBC debacle, AT&T execs are talking about pursuing another acquisition. The most likely targets: GTE Corp. and Southern New England Telephone Co.—companies with which AT&T has talked merger in the past. Although AT&T has not yet restarted talks with either, "they've pretty much said they want to do a deal," says one source.

Another potential partner is Teleport

C. Petrillo, AT&T's executive vice-president for corporate strategy and business development. Likely partners include McLeod USA Inc. in Cedar Rapids, Iowa.

Such deals will never make AT&T a local power, though. "It's like stringing tin cans together and tying it with a knot," says Gary Miller, chairman and CEO of Aragon Consulting Group in St. Louis. And stitching together dozens of partnerships will be costly. "All I can see is a network that's getting complex, and complexity to me means expensive," says Daniel E. Zito, vice-president at Legg Mason Wood Walker Inc.

Another easy option for AT&T is a strategy Allen has resisted—reselling service provided by the local Baby Bell. AT&T contends that with the 18% to 20% off of retail calling prices that the Bells typically offer, it can't afford to market and sell local service. In long distance, there's a thriving resale business, but



EN: Lots of capital spending, but progress has been slow

is expected to bring to its core long-distance business.

So far, AT&T has launched a half-dozen local-phone strategies—from simply reselling services bought from local incumbents to pioneering a new system of "fixed wireless" residential service. It has dramatically increased its capital spending this year from \$6.6 billion to \$9 billion to accommodate \$1 billion slated for building local networks. Still, none of the approaches—save the now defunct merger option—appears to have the potential to get AT&T into the \$100 billion local market in a big way any time soon. Says Jeffrey Kagan of Kagan Telecommunications Associates: "They're not anywhere

near where they wanted to be or where analysts expected them to be."

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Another potential partner is Teleport Communications Group Inc., which provides local service to businesses in large cities, in competition with the Baby Bells. BellSouth Corp. and Ameritech Corp. have also been mentioned as merger candidates at various times, but such deals are unlikely unless the FCC drops the theoretical AT&T-Baby Bell combination.

TIN-CAN ALLEY? For now, the long-distance giant will pursue less ambitious options—such as marketing deals with small companies that compete with the Bells, usually by linking business customers to long-distance networks. In the next three months, AT&T plans to announce franchise agreements under which it would receive royalty payments and the local company could use the AT&T brand to sell service. "We want to leverage our brand name and save on the amount of money we have to invest in local infrastructure," says John

AT&T'S MULTIPLE-CHOICE TEST

To get into local-phone service, the telecommunications giant could:

- (A) Buy GTE or Southern New England Telephone. Neither would present the political or financial problems of the aborted SBC deal.
- (B) Expand its partnerships with "alternative carriers," small companies with local phone networks that compete with Baby Bells.
- (C) Sacrifice short-term quarterly earnings and speed up its investments in building local-phone systems. This would cause problems on Wall Street but would please federal regulators.
- (D) All of the above.
- (E) None of the above.

the discounts range as deep as 70%.

Allen, in fact, has been an outspoken critic of what he says are intentional strategies by local-phone companies to foil new competitors (page 26). The company stopped marketing in Sacramento earlier this year because it said that Pacific Bell was slow to connect its customers. In Rochester, N. Y., AT&T exited the resale business because Frontier Corp. offered only a 5% discount. Still, AT&T continues to pursue resale markets in several states, mainly to build customer loyalty by providing a full bundle of phone services.

The net result: AT&T's efforts in local calling have yielded little. A recent Yankee Group Inc. study shows that AT&T has won about half of the households that have chosen an alternative to the local phone company—but that's only about 200,000 customers. Just last year, Allen was boasting that AT&T would

take one-third of the local market.

There is a costly, long-term approach that could produce bigger numbers: AT&T can speed up plans to build local connections, such as it is currently pursuing in Chicago where it's testing new wireless technology. A nationwide system, however, would cost as much as \$100 billion, and Wall Street, which already went on a rampage over this

year's increase in capital expenditures, is unlikely to sit still for any effort that places such a drag on earnings.

Regardless, AT&T has no choice but to come up with a local-phone strategy soon—particularly because the Baby Bells are so intent on getting into long distance. Just days after their merger talks broke off, in fact, SBC was suing in federal courts in Texas and Washing-

ton, challenging the FCC's right to keep it out of long distance until it opens up local calling in its markets. "AT&T has to get into the local-service business," says Guy W. Woodlief, telecom analyst at Prudential Securities Inc. "It's their opportunity for growth." Allen, who has scheduled his retirement for next year, has little time to seize that opportunity.

By Peter Elstrom in New York

THE LOCAL-PHONE WAR HEADS FOR COURT

Last February, Virtual Spin, a Seattle-based software company, suffered a two-month setback when programmers couldn't dial into a private telecommuting network provided by Electric Lightwave Inc. (ELI), a new local phone company. "It was a nightmare," says Spin President Brook W. Lang. But he doesn't fault Electric Lightwave. He blames U S West Communications Inc., the local Baby Bell phone company that was supposed to provide adequate phone lines to Electric Lightwave's customers. U S West, says Lang, installed voice lines instead of the needed data lines. U S West claims the mistake was the new company's. But Electric Lightwave isn't letting the matter drop. On June 30, the Vancouver-based company filed an antitrust suit against U S West, charging it with using its "monopolistic" powers to block the entry of competitors into the local-phone market.

Electric Lightwave is not the only one taking the telephone wars to the courts. On July 2, SBC petitioned a federal court in Texas to rule unconstitutional provisions of the Telecommunications Act of 1996 that allow the federal government to regulate the entry of the Baby Bells into the long-distance market. The next day the company was prepared to file a similar but more limited suit in Washington, challenging the FCC's denial of SBC's petition to offer long-distance service in Oklahoma.

Telecom experts now predict that the courts will soon be filled with phone war participants. Considered the most likely litigants are local phone wannabes, possibly including such powerful players as AT&T and

MCI. Says Washington telecom lawyer Richard M. Rindler: "The inherent interest of a monopolist to remain a monopolist is something the courts will eventually have to deal with."

The Electric Lightwave suit clearly reflects the tremendous frustra-



WIRED: Bells say they're building as fast as they can

tion of would-be competitors in local-phone markets over their lack of progress. Long-distance companies ranging from tiny startups to AT&T are complaining about obstacles they face in getting basic services they need from the Bells to enter local markets, as mandated by the Telecommunications Act of 1996. The Bells, they charge, are deliberately dragging their feet. "I've not yet seen a single Bell company obey the letter or spirit of the law," fumes MCI Communications Corp. President Timothy F. Price.

Meanwhile, local upstarts are taking their gripes to regulators, too. On May 30, LCI International filed a petition with the Federal Communications Commission seeking a firm deadline for Baby Bells to provide new local-market entrants access to automated customer-service systems. The lack of such access makes it diffi-

cult for new companies to sign up customers, says LCI. On June 24, MCI filed a complaint with the Washington Utilities & Transportation Commission, charging that U S West is slow in providing access to billing systems.

The FCC has already shown that it finds the evolution of local competition inadequate as well. On June 26, it rejected SBC's application to enter the long-distance market in Oklahoma because of the Bell's apparent failure to open its own local markets to competition. That sparked SBC's July suit. Similarly, the Justice Dept. has recommended that the FCC deny Ameritech Corp.'s bid to enter Michigan.

CHERRY-PICKING? The Bells claim they are working as fast as they can to install new local-phone capacity for rivals, who then resell service. And they complain that, for their trouble, they watch helplessly as newcomers cherry-pick the best customers. U S West has added 8,900 new lines for Electric Lightwave. And in 1997, it expects to add 75,000 new lines, at an estimated cost of \$40 million to \$60 million. Moreover, U S West claims that it meets 75% of reseller requests on time. Most of the rest, it says, require new construction. "We feel we're bending over backwards," says Christine H. Butler, U S West's director of technical, regulatory, and financial initiatives.

Skirmishing among the Bells and new rivals is likely to intensify. The battle for the \$100 billion local-phone business is now being waged on all fronts—in the courts, in the regulatory agencies, and in the market.

By Catherine Yan, in Washington

By Howard Gleckman

DEATH, TAXES—AND CORPORATE WELFARE?

Earlier this year, reformers were bravely predicting that Congress would trim some of the most egregious corporate tax breaks from the revenue code. Boy, were they wrong.

As lawmakers draft the biggest tax cut since 1981, they can't resist riding it with business pork—literal. Wealthy pig farmers, along with other livestock producers, are about to get huge new tax benefits. And the richer the farmer, the bigger the break.

Hog farmers aren't the only ones in the trough. Not only

lawmakers lured to kill existing special-interest write-offs,

they are busily eating new ones: oil and gas drillers, ethanol producers, fish processors, and drug companies are just a few of the beneficiaries. As it gets harder to increase spending, lawmakers in both parties look to the tax code to help their friends. "It's just a political grab bag," says Brookings Institution tax economist William Gale. "Whoever can get a subsidy keeps it."

Never mind that these loopholes only encourage economic growth, as their backers claim. At best, they are a waste of taxpayers' money. At worst, they actually discourage innovation by subsidizing old technologies.

NORMOUS SETBACK. The bill moving through Congress is not only a setback for critics of corporate welfare, it's a huge defeat for the backers of tax restructuring. Republican leaders say they believe deeply in reworking and simplifying the code. But the bill moving through the Republican-dominated Congress is anti-reform. "It's an enormous setback for the flat tax," says Robert J. Shapiro, co-president of the Progressive Policy Institute, a moderate Democratic think tank. Instead of dumping targeted write-offs and cutting rates, most tax reformers want, Congress keeps trying to pick winners

and losers. "You kind of want to cry," says Barry K. Rogstad, president of the American Business Conference, which represents midsize growth companies.

The biggest blow to reform came when House Ways & Means Committee Chairman Bill Archer (R-Tex.) backed off from his proposal to dump the \$600 million a year tax subsidy for corn-based ethanol, a gasoline additive. The break mostly helps

meals eaten on the job by fish processors and airline pilots.

And what about those pig farmers? They are getting a huge new tax break, thanks to the proposed cut in capital-gains rates. A top-bracket farmer can already deduct the cost of raising livestock. But because profits from the sale of an animal can be treated as a capital gain rather than ordinary income, wealthy farmers would pay only a 20% tax

BUSINESS TAX BREAKS AS USUAL

ETHANOL Efforts to scale back this perennial subsidy for corn-based fuel that primarily helps Archer Daniels Midland were scuttled by the House GOP leadership. Annual cost: \$500 million.

TIAA-CREF Another hardy perennial, this tax exemption benefits a pension fund is used by employees of educational institutions. TIAA-CREF also sells annuities and other insurance products to teachers. Annual cost: \$100 million.

RESEARCH AND DEVELOPMENT Scheduled to expire this year, this tax credit looks like it will be extended until 1999. Supporters say it helps startups, but since these small enterprises are rarely profitable enough to pay significant taxes, it becomes a windfall for giants such as Microsoft. Annual cost: \$1 billion.

COMPUTER DONATIONS Both bills would create new tax incentives for business gifts of hardware to schools. Annual cost: \$50 million.



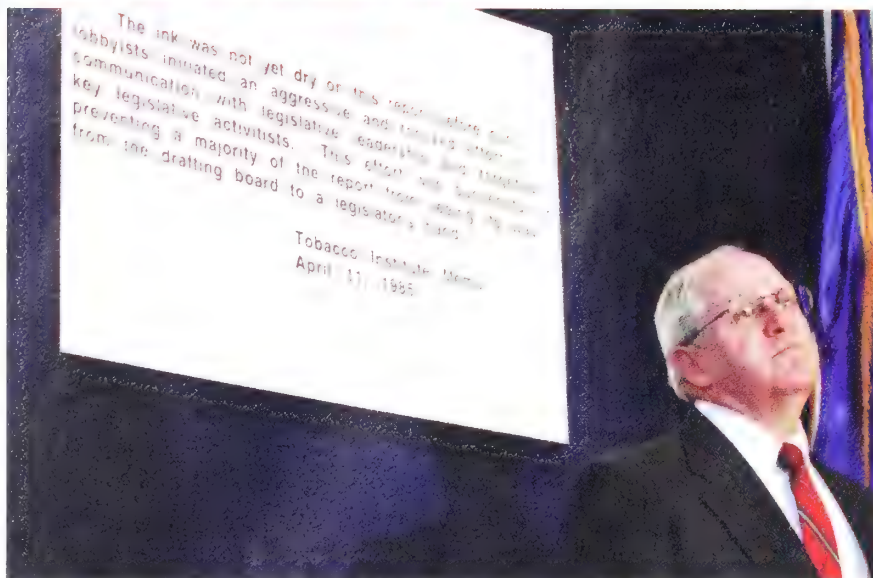
Archer Daniels Midland Co., which gave the Democratic and Republican parties a total of \$700,000 in '96. One of ADM's powerful friends, House Speaker Newt Gingrich (R-Ga.), first forced Archer to water down the plan. Now, with the Senate and President Clinton opposing any change, even efforts to weaken the ethanol subsidy have been abandoned.

Other business breaks also remain intact. A tax credit for research and development was supposed to expire this year. But both the House and Senate bills would extend the \$1 billion a year subsidy at least through 1999, although both promise to phase it out after that. Even worse are the new goodies, which give preferences to low-production oil and gas wells and businesses that donate computers to schools, as well as extra-generous deductions for

rather than the 39.6% that usually applies to anyone in the top bracket. The subsidy is so sweet that some farmers may spin off breeding herds and lease them back to their own operations, predicts Chuck Hassebrook of the Center for Rural Affairs, a family-farm advocacy group in Walthill, Neb.

That's just the problem with corporate welfare. It sends farmers running to accountants to find new tax dodges when they could be spending their time finding better ways to raise pigs. But even in an era of fiscal restraint, when Congress and President Clinton are asking everyone from seniors to poor children to sacrifice, corporate welfare remains untouchable.

Correspondent Gleckman covers economics and tax policy from Washington.



LEGAL AFFAIRS

SO MUCH FOR SMOKING OUT BIG TOBACCO'S SECRETS

The deal may let companies keep documents under wraps

When Mississippi Attorney General Mike Moore announced the proposed \$368 billion tobacco settlement on June 20, he claimed that it would force the industry to turn over a treasure trove of previously secret internal documents. "We wanted to make sure that every single person, not only in America but this entire world, knows the truth about what the tobacco industry has done.... And we are satisfied that we have done that," Moore exulted.

Critics of the deal now charge that Moore's declaration is an empty boast. In fact, they say, the pact may actually prevent the disclosure of documents that would have come to light through litigation. When the settlement was announced, tobacco foes immediately pounced on how the pact limits nicotine regulation and treats company liability. But Minnesota Attorney General Hubert H. Humphrey III has said that document disclosure is an issue of equal importance: "This fight was supposed to be about lies and cover-ups, but this deal allows the and cover-ups to live on."

The fight over disclosure

threatens to create another major hurdle for the proposed settlement. Alan Morrison, the attorney analyzing the deal for the review committee chaired by former Food & Drug Administration Chief David A. Kessler and former Surgeon General C. Everett Koop, says that as the deal stands, "the most significant documents will still be withheld...for many years, and possibly forever." And Representative Henry A. Waxman (D-Calif.) on June 12 introduced a bill that would require the companies to surrender far more paperwork than is required under the pact.

The main criticism of the deal's disclosure provisions is that they let the in-

HUMPHREY: "This deal allows the and cover-ups to live on"

dustry continue shielding incriminating papers behind attorney-client privilege. Last month, for example, Waxman revealed that Liggett Group Inc. had used attorney-client privilege to keep confidential a memorandum in which attorneys told the company not to market safer cigarette because "it may accelerate tobacco litigation."

"WOEFULLY DEFICIENT." Tobacco antagonists have no way of knowing exactly what information the industry has hidden. But Stanton A. Glantz, professor at the University of California at San Francisco and a longtime tobacco critic, believes that companies may use privilege to avoid releasing medical research, information on plans to recruit teenagers, studies of the damage of tobacco, and memos on political strategy. He says such revelations would be highly valuable to Congress—especially as members consider how the industry should be punished and weigh how strict time should be regulated.

The tobacco papers can be unstable under the proposed settlement—In each case a panel of three federal judges must rule on whether the privilege protection should be waived. Morrison calls that "woefully deficient." Jacksonville (Fla.) plaintiffs' attorney Norwood S. Wilner, who has more than 100 private personal-injury suits against the industry, says companies could stall the panel by insisting on line-by-line review of mountains of paperwork. "It will take years to get it resolved," says Wilner. "I don't have the resources to deal with [that]."

Wilner, Waxman, and Morrison want the companies to abandon their claim to attorney-client privilege. Liggett did in its March settlements. One tobacco lawyer says this demand is unfair and has never been imposed on an industry before—"nothing close."

Matt Myers, executive director of the Campaign for Tobacco-Free Kids and a negotiator of the pact, argues that the agreement furthers disclosure. "This system moves the ball in terms of document disclosure way ahead of where it would be if we just continued to pursue the litigation," he says. But that may not be enough.

By Mike France in New York, with Gail DeGeorgio in Miami and John Carey in Washington

Losing the Paper Trail

INCOMPLETE DISCLOSURE The deal does not force the companies to turn over hundreds of thousands of documents covered by attorney-client privilege.

RED TAPE Tobacco opponents can appeal industry claims of attorney-client privilege, but that requires approval by a special three-judge panel.

LAWSUIT LIMITS Because the settlement imposes barriers on future suits, critics worry that lawyers won't try to obtain attorney-client documents.

DATA: PUBLIC CITIZEN LITIGATION GROUP

By Paul Raeburn

SAVING LIVES DOESN'T HAVE TO COST A BUNDLE

Smoking kills 400,000 Americans each year. So the \$10 billion that the tobacco industry would pay in the first year under the proposed \$368 billion settlement now before Congress amounts to a mere 25,000 per life. Is that all a life is worth?

Not according to the Environmental Protection Agency. When it assesses its regulations, it values a life—that is, the life of a thirtysomething worker—at about \$5 million.

If the tobacco industry had been asked to use the EPA's figure in the recently negotiated settlement with state attorneys general, the cost for the 400,000 lives lost annually because of tobacco would have been \$2 billion per year. The state attorneys general used still another set of numbers, though. They wanted the industry simply to compensate them for what their states will pay to treat victims of smoking-related illnesses.

But there's a problem with all this arithmetic: states are actually saving millions of dollars, perhaps billions, when taxpayers smoke. The reason is that lung cancer kills quickly and efficiently, often before its victims can collect from Medicare or Social Security. Smokers are also more likely than nonsmokers to drop dead of a heart attack, a tidy, frugal death that doesn't consume a penny's worth of medical care.

O CORRELATION. Such are the weird economics that come into play when efforts are made to put a price on a life or a public-health program. Tammy O. Tengs of the University of California at Irvine and John D. Graham of the Center for Risk Analysis at the Harvard

School of Public Health tried to make sense out of all this by determining how much various public-health measures cost for each year of life they save. Instead, they found dazzling examples of money being badly spent.

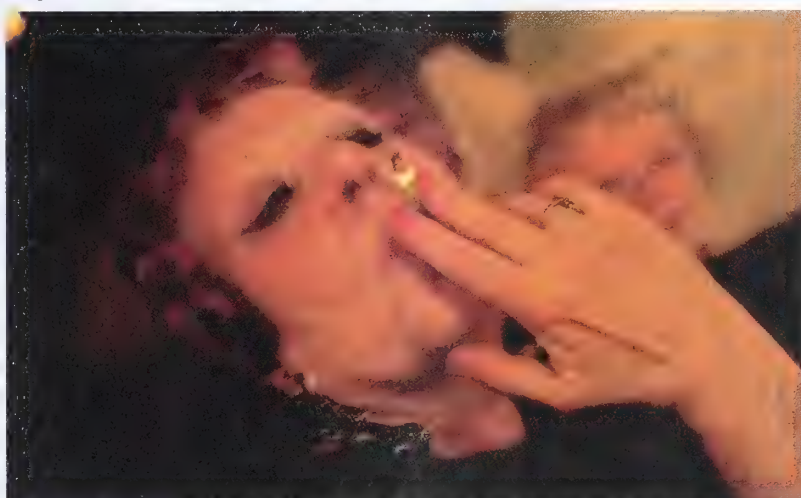
For example, the cost of furnishing doctors with gloves and masks to protect them from AIDS is \$2.4 million per year of life saved. The figure comes from dividing the costs of gloves and masks by the number of deaths that would have occurred if

applying dollars-and-sense logic to public health? These calculations don't factor in what really counts to human beings. Yes, it might be costly to give doctors rubber gloves and masks. But who would argue for discontinuing a practice that reduces the risk of contracting AIDS? It's also difficult to imagine Congress taking fire retardants out of children's pajamas.

Sure, we need to pay attention to the numbers. Health care is expensive, and we must pick our targets.

With careful consideration of the costs, we could design a far more rational system that would save many more lives.

The danger is that the economics will be misused. If smokers are saving states money, economics suggests that instead of taxing them, we should subsidize them. Cost-benefit analyses of proposed environmental regula-



CHEAP FIXES

Doctors, for example, often fail to urge patients to quit smoking—one of the most cost-effective health measures

they hadn't been used. Those same doctors, however, often fail to take the time to urge patients to quit smoking, a measure that costs \$6,000 worth of doctors' time for each year of life saved, after accounting for only some patients following the advice.

The cost of making children's pajamas fireproof is \$1.5 million per year of life saved. Yet 30% of those children live in homes without smoke detectors, which cost only \$200,000 per year of life saved. Benzene emission regulations at waste plants can reduce cancer deaths at a cost of \$19 million per year of life saved. Giving mammograms to women over 50 who do not get them regularly would cost only \$17,000 per year of life saved. In short, Tengs and Graham found no correlation between a measure's cost-effectiveness and whether the measure was actually being used.

Why aren't we more consistent in

tions all too often lead to the conclusion that we should do nothing to preserve a pristine wetland, say, because the costs are too high.

TUG ON THE HEART. So, while it's important to consider what a life is worth, it's equally important not to be ruled by the numbers. We should allow ourselves a little irrationality, a little tug on the heart now and then—as we did 10 years ago when baby Jessica McClure stumbled and fell into a well in Midland, Tex., and was trapped 22 feet underground. Hundreds of rescue workers labored around the clock until Jessica was brought out. An entire community mobilized to save one life. Similarly, our health and environmental policies affect millions of people whom, like Jessica, we want to help regardless of the cost.

Was saving baby Jessica a cost-effective use of scarce public-health resources? Who cares?

Raeburn is BUSINESS WEEK's senior editor for science and technology.

DETROIT

FORD HAS A TIGER IN ITS TANK

Jack Nasser has turbocharged Detroit's laggard



IN THE DRIVER'S SEAT? Nasser looks primed for the top spot at Ford

At Steve Kalafer's two Ford dealerships in Flemington, N.J., salesmen don't have to do much arm-twisting to move the metal these days. With Ford killing off slow-selling cars like the Thunderbird, Kalafer's sales staff can concentrate on pitching models, like the Expedition, that the public seems already sold on. "I have not heard one voice of condolence for the loss of the T-bird," says Kalafer. "We have to focus on what we do best."

Ford Motor Co., Detroit's laggard in auto profits last year, is enjoying a startling reversal of fortune. Feisty Automotive President Jacques A. Nasser, installed October 1996, is living up to his promise to engineer a quick fix of Ford's sputtering auto business. By junking slow-selling models, squeezing suppliers for price cuts, and slashing jobs, Nasser is on track to cut some \$2 billion in costs this year. "Nasser finally got everyone scared," says Lehman Brothers Inc. analyst Joseph Phillippi.

The result: Ford's second-quarter profits are expected to soar above \$2.1 billion. For the first time since 1988, Ford should outearn General Motors Corp., which lost \$490 million to strikes

in the second quarter. The quarter will almost undoubtedly be a record-breaker for Ford and the auto industry: The company could earn as much as \$2.5 billion, predicts Merrill Lynch & Co. auto analyst Nicholas Lobaccaro. "All the planets are aligned for Ford," he says.

How is Nasser fixing Ford so fast? The blunt-talking Aussie, who likes to brag that he has never missed a cost target, has been forcing Ford's free-spending managers to change their ways by cutting travel budgets and freezing discretionary spending, insiders say.

Nasser, 49, is also an opportunist and a quick decision-maker. He has capitalized on the market's warm response to the Expedition by converting an entire Michigan factory to producing the big sport-utility vehicle, which earns an eye-popping \$10,000 gross profit per unit. Analysts say the Ex-

pedition, which is expected to rack up first-year sales of more than 250,000, is generating half of Ford's auto profit. And on July 1, Ford rolled out the Lincoln Navigator, an upscale version of the Expedition that sells for around \$44,000 and could generate \$15,000 profit per vehicle. "Without the Expedition, Nasser might not look so good," says Schroder Wertheim & Co. analyst John Casasa.

Indeed, Nasser will be hard pressed to match his own breakneck pace in the second half. The U.S. auto market is already turning down, and as auto sales slow, Ford's margins—like those of other U.S. carmakers—will be squeezed by rising rebates, analysts say. The carmaker already offers rebates of \$1,000 on some Lincolns and \$1,000 on the Explorer, which has suffered a 10% sales decline this year. Ford's overall sales are already down 3% so far this year. "Nasser is running out of time with the market," says Casasa.

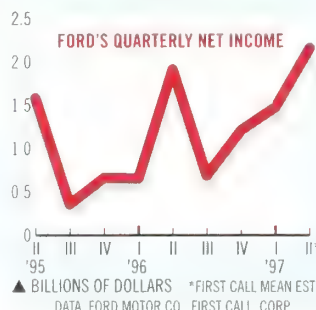
QUIRKY. As the U.S. sours, Nasser is working hard to make money abroad. He is spending much of his time on road cleaning up Ford's foreign auto operations, which unexpectedly lost \$2 million last year. He is aggressively cutting jobs and parts costs in Europe. And Ford's Ka small car helped boost the auto maker's overall Brazilian sales 76% this year.

To extend Ford's recent success, Nasser is also quietly backing away from Chairman Alexander J. Trotman's 2000 global reorganization, which aimed to save money by vesting worldwide control in Dearborn headquarters. Nasser is returning power to Ford's regional operations and sources close to the company say he is dismantling the remarkably expensive \$6 billion wheelcar program that gave birth to the Contour in the U.S. and the Mondeo in Europe. "If Alex were there, Nasser would move even further away from Ford 2000," says a source close to the company.

Nasser soon may have a chance to cut his own course for the carmaker. With Trotman scheduled to retire on Jan. 1, 2000, the company's board is said to be favorably inclined to turn over the CEO's keys to Nasser. He certainly did well in this quarter's road test.

By Keith Naughton in Detroit

SPEEDING TOWARD A RECORD





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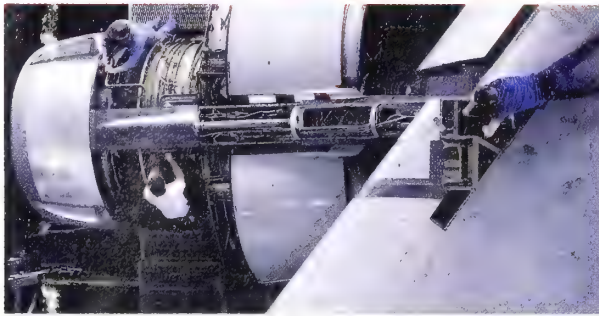
STRATEGIES

BOEING AT YOUR SERVICE

After the merger, it may maintain 77% of all airliners

It's not the orders for 185 new McDonnell Douglas Corp. planes that will keep Boeing Co.'s commercial aircraft business hopping if the merger of the two aerospace companies is completed. Compared with Boeing's 1,418-plane backlog, the McDonnell orders don't amount to much. No, what will keep Boeing busy is the prospect of providing auxiliary services to 7,000 Boeing and 2,900 McDonnell Douglas planes worldwide. Boeing could soon find itself providing services—possibly including maintenance—for 77% of all commercial airliners.

The aircraft giant has always provided services such as engineering support and emergency repair for commercial aircraft customers. But with a new division, Boeing Enterprises, it's ready to



DOWNTIME: Upkeep is less cyclical than manufacturing

make a business out of supplying route information and installing entertainment systems. Now it's also eyeing other services, such as maintenance. Revenues from the new work could top \$4 billion by 2000, says Nicholas P. Heymann, an analyst at Prudential Securities Inc.

CUSHION. Boeing shouldn't count on the money too heavily. Some carriers bristle at handing the giant more business. "I can't even envision Continental letting Boeing do our maintenance," says Continental Airlines CEO Gordon M. Bethune. Still, Boeing will push ahead. For one thing, maintenance is less cyclical than manufacturing, so it could provide an earnings cushion for Boeing in a

downturn. Also, Boeing can get closer to carriers—including those with aging McDonnell Douglas fleets—that may be shopping for replacement planes. "Service is a selling point," says M. J. Bethel, executive vice-president of Boeing Commercial Airplane Group.

That worries European rival Airbus, which

is already concerned about Boeing's supplier contracts with several airlines. "It puts Boeing in the position to capture that market when those planes are up for replacement," says a spokesman for Airbus Industrie North America Inc. Airbus is voicing its concerns to the European Union, which is expected to hand down an opinion on the merger by August.

Boeing is negotiating with the airlines to alleviate its concerns, however, and has scheduled a July 25 shareholder meeting to approve the deal. The company hopes to get on with the business, keeping nearly 10,000 planes aloft.

By Seanna Browder in Seattle

SPORTS BUSINESS

COSTS ARE OUT OF THE BALLPARK

Baseball has become too pricey for individual owners

On June 26, in front of a gaggle of reporters and the glare of television lights, H. Wayne Huizenga conceded defeat. An entrepreneur extraordinaire and a builder of three \$1 billion-plus corporations, Huizenga admitted he was not able to make the economics of baseball ownership work. After investing seven years and \$200 million, he was putting the Florida Marlins on the block.

Huizenga's announcement came as discussions were continuing between Los Angeles Dodgers owner Peter O'Malley and media baron Rupert Murdoch. There is a possibility Murdoch's News Corp. may buy the team and its valuable real estate for \$350 million to \$400 million.

HURRICANE. What's going on? Baseball has become too costly and volatile a business for individual owners. "Professional sports today is as high-risk as

the oil business," O'Malley said in announcing his Jan. 6 decision to sell the Dodgers. "You need a broader base than an individual family to carry you through the storm."

Hurricane may be a better word for what has happened to baseball profits. While the sport has recovered from its dismal showings in 1995 after a seven-month strike, attendance is still down 15% from prestrike days. Meanwhile, payroll costs are up sharply. The Dodgers, for instance, just signed catcher Mike Piazza for two years for \$15 million. With his salary, the team's low ticket prices, the stadium's lack of sky-box revenues, and O'Malley's refusal to allow advertising on stadium walls, the team should barely clear a profit this year despite selling 3 million tickets.

The Marlins' escalating losses—which jumped from \$18 million in 1995 to \$30 million last year—can be

blamed on the boss's overspending, Huizenga admits. He opened the payroll strings to sign such stars as right fielder Gary Sheffield (\$10 million a year for six years) and pitcher Alex Fernandez (\$7 million a year for five years). Huizenga has boosted the Marlins' payroll to \$30 million from \$32 million in 1996. So far, though he owns the stadium, the Marlins play in and a majority stake in the



SHEFFIELD: Huizenga can't cover the Marlins' lofty payroll

stadium that carries the team through their games, and even though attendance is up 30% from 1995, Huizenga still says the team isn't profitable.

Huizenga's announcement that he plans to sell the team has sparked speculation that he's simply angling for political funding for a new stadium. But Huizenga says he is determined to sell. A Marlins executive says that it's just a matter of simple math, explaining, "If Wayne was making money, he would not sell the team."

By Gail DeGuerre in Miami

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EDITED BY KELLEY HOLLAND

A LOSS OF MEMORY AT MOTOROLA

WITH PRICES FOR COMPUTER memory chips continuing to head south, Motorola on July 1 pulled the plug on its production of low-margin DRAM (dynamic random-access memory) chips. Motorola says it will phase out DRAM production by year-end and focus instead on microprocessors and other "logic" chips. Motorola will still make some DRAMS at a joint-venture factory now being built in Richmond, Va. But when the billion-dollar plant goes on stream next year, all the DRAM chips will be marketed by Germany's Siemens, Motorola's partner in the plant. And once the new plant is up to speed in 1999,

Motorola will switch its half of production to other types of chips, such as flash memory chips.

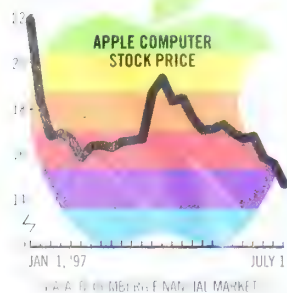
FASB HAS MORE PAPERWORK FOR YOU

GET OUT YOUR EYESHADE. IN addition to operating income, companies must now report "comprehensive income" on financial statements, says the Financial Accounting Standards Board. That includes currency adjustments, securities purchases, and pension liabilities. The change will complicate reporting requirements, but another potential rule change could cheer Corporate America: a recommendation to eliminate charges for goodwill amortization, which companies must sometimes deduct from earnings for up to 40 years after a merger.

CLOSING BELL

POMMELED

How low can Apple Computer go? On July 1, shares fell to an 11-year low of 13½ as bad news continued for the Cupertino (Calif.) company. Top Mac clonemaker Power Computing said it will build machines using Intel chips and Microsoft software. And Apple broke ranks with a top education market reseller June 30. Then there was a 1.5 million-share trade of Apple stock on June 26 that sparked rumors co-founder Steve Jobs had sold his stake. Jobs won't comment.



PHYSICIAN, GET THYSELF AN MBA

COLUMBIA/HCA, ALWAYS MINDFUL of the bottom line, is trying to ensure its doctors do the same. On July 1, the hospital giant announced it would join with the University of Tennessee's College of Business to create an executive MBA program for its physicians. Michael Stahl, associate dean of UT's College of Business Administration and director of the new program, says it's in response to managed care. "Physicians don't know how to function in that environment, and Columbia is interested in transforming them into a leadership role," he says.

TAKE YOUR HANDS OFF MY SPAM

WHAT A FOOD FIGHT. CYBER Promotions, one of the companies that bring you junk electronic mail, is in a trade-

HEADLINER: THOMAS STEMBERG

BAD DAY AT THE OFFICE

Thomas Stemberg lost a grueling 10-month court battle on June 30, when a federal judge blocked the Staples CEO's plans to acquire archrival Office Depot. So what's ahead for the office-supply superstore?

Despite the setback to Stemberg's instant expansion plan, Staples is expected to produce healthy profits for the next several years. Competition in the industry remains bruising, but Staples is growing briskly: Sales were up 26% in the second quarter and operating profits rose 54%. Robinson-Humphrey ana-

lyst Daniel Wewer expects Staples sales to grow about 25% annually for the next three years, while profits will grow about 30% a year. In addition, Staples is continuing to open stores at a breakneck pace. At the end of the year, it will have more stores than Office Depot, which slowed expansion while the Staples deal was pending. "We have a bright future as an independent company," Stemberg says. The future would have been just a bit brighter, though, if the judge hadn't spoiled his plans.

By Geoffrey Smith



mark dispute with Hormel Foods over the use of the word "spam" in cyberspace. On July 2, Cyber Promotions rejected Hormel's demand to stop using its site in the World Wide Web, "www.spamford.com"—a takeoff on the name of Cyber Promotions' president, Sanford "Spamford" Wallace. Cyber Promotions argues that in cyberspace, "spam" is understood to refer to the sending of unwanted E-mail, and there is no confusion with Hormel's famous meat product. Hormel has no Web site, a spokesperson says, but the company is still sizzling mad.

EMI GETS AN EARFUL OF MOTOWN

THE MOTOWN LEGACY HAS become something of an annuity for Berry Gordy, the onetime Detroit auto worker whose music label introduced the Temptations, the

Supremes, and the Jackson 5. Gordy, 67, who sold the label for \$61 million to Polygram in 1988 but held on to its song rights, sold a 50% stake in those rights to Motown for \$132 million on June 26. The 15,000-title catalog, which includes such classics as *Heard It Through the Grapevine* and *My Girl*, generates roughly \$10 million in operating cash, says Maurice Bandier, EMI's music publishing chairman. Gordy holds the other 50%.

ET CETERA...

- Rockwell International Chairman Donald Beall, 81, is retiring in October.
- Raytheon won approval to buy Texas Instruments' defense electronics unit.
- General Motors' June auto and truck sales were down 13% from 1996's levels.
- Japan closed Tokyo Bay in response to a 3.9 million-gallon oil spill, its worst ever.

EDITED BY OWEN ULLMANN

REPORT FROM THE HEARTLAND: SHOULD REPUBLICANS BE WORRIED?

It's a fry-an-egg-on-the-pavement afternoon in tiny Hardin, Ill., but a few of the faithful are already waiting in the wetter for John M. Shimkus as the Republican congressman parks his red Chevy pickup. Like dozens of his fellow representatives, Shimkus is using his Fourth of July recess to savor the flesh and gauge the mood of voters. At a meeting in the courthouse, Shimkus trumpets GOP successes in forging plans to cut taxes and balance the federal budget, but folks in the rural Illinois district don't seem all that interested: They want to know about local issues like a new ferry across the Mississippi by Illinois River and a federal road project that threatens property rights.

Such hot Washington topics as GOP leadership feuds just

aren't on Hardin's radar screen. "It's tremendously quiet here," says Shimkus, a congressman who barely won a reelection the Democrats had for years. "The economy is slowing, people are employed. It has got to be good for Democrats."

You'd think so. With the economy booming and their agenda being enacted, Republicans should be dreaming of winning a narrow 11-vote margin in the House come the next elections. History is on their side: In five of the past 10 midterm elections during President's second term, the GOP outside the White House gained more than 40 House seats. But while the party will likely strengthen its

control of the House next year, it can't count on a blowout. Why? Although voters seem complacent now, they'll start asking more on Washington as the election nears. Democrats are expected to exploit disarray among GOP leaders and play the old class-warfare card. For starters, Newt Gingrich (R-Ga.) remains burdened by ethics woes and a strident image he can't shake. The House Speaker is still a big draw with Republicans at charity functions and fund-raisers: He was the main event at a barbecue for Shimkus that pulled in \$50,000. But with the general public, Gingrich remains the most unpopular pol in the nation. A June 26-29 CNN/USA Today/Gallup poll found that 60% of respondents thought Republicans should replace him as Speaker. Unease about his leadership also sowed discord among his lieutenants, leaving the perception of turmoil within the GOP.

More important, Democratic harping on House GOP tax-cut proposals as giveaways for the rich seems to be seeping into public consciousness. In the poll, 61% of the 1,013 adults surveyed said the GOP-run Congress is out of touch with everyday people. And by a margin of 40% to 34%, they

would prefer to see the Democrats running Congress again.

The good news for the GOP is in the Senate, where Democrats have hardly a prayer of retaking control. Republicans are confident they can widen their current 55-45 margin, but they'll likely fall short of the magic 60 seats needed to fend off filibusters. The GOP is eyeing seats held by retiring Democrats John Glenn (Ohio), Wendell H. Ford (Kentucky), and Dale L. Bumpers (Arkansas). And first-term Democrats Carol Moseley-Braun of Illinois and Patty Murray of Washington are vulnerable. Democratic opportunities? The GOP's Dan Coats of Indiana is retiring, and the right challenger could give New York's Alfonse M. D'Amato a tough run.

In the House, Republicans such as Shimkus concede that



A new poll says 60% of respondents think Newt should be replaced

SHIMKUS AND GINGRICH AT A RONALD McDONALD HOUSE

as the recent flood-relief debacle have made Republicans appear uncaring and boosted Democratic recruitment and fund-raising. "Potential candidates are much more willing to run than they were two years ago," says Representative Martin Frost (D-Tex.), chairman of the Democratic Congressional Campaign Committee. Frost also credits Gingrich & Co.'s woes with helping the DCCC pull in \$5.4 million in the first five months of '97, up 30% from '95.

That will help the Dems, but the GOP still tends to outraise them 3 to 1 in congressional races. Next year could be even more lopsided. Hurt by Donorgate fallout, the Democratic National Committee is in debt and won't be able to funnel gobs of money to key candidates. And although the GOP tax-cut bill gives Democrats an opening to reinforce the stereotype of Republicans as pals of the wealthy, the "fairness" issue could fizzle once Clinton signs a compromise tax cut.

Still, with their leaders lurching from crisis to crisis, House Republicans may have to settle for modest gains—even though history and the economy would suggest otherwise.

By Amy Borrus in Hardin, Ill.

SWITZERLAND

MAN ON A CRUSADE

Blocher's Nazi gold campaign

It was late September, 1995, and at an outdoor political rally in Zurich, Christoph Blocher was giving a familiar speech. He warned that Switzerland must not risk its autonomy by getting too close to the European Union. But this time the affair got out of hand. Skinheads who had assembled to support Blocher began throwing stones at the hundreds of anarchists massed on the other side of the Limmat River to heckle the speaker. A two-hour riot ensued downtown, with the anarchists breaking windows, overturning cars, and hurling abuse at baton-wielding police.

Not your typical executive lecture. But then there's nothing typical about the man who gave it. Blocher, 56, is one of Switzerland's most successful entrepreneurs, as head of EMS-Chemie Holding—and its most controversial politician. In a 1992 referendum, when the Swiss narrowly rejected formal association with the EU, Blocher was widely credited with swaying public opinion.

Now, Blocher, leader of the right-wing populist Swiss People's Party in the canton of Zurich, has taken up an even thornier issue expected to come to a referendum in 1998 or 1999:

whether Switzerland should use its gold reserves to create a \$5 billion fund for victims of Nazi and other crimes. Blocher firmly opposes the idea. He also believes the Swiss central bank should not contribute to a separate \$185 million fund for Holocaust survivors and their heirs.

FOLKSY ELOQUENCE. To his critics, Blocher is a provocateur. But he also taps into a deep strain of conservatism and nationalism, especially among German-speaking Swiss. And he is increasingly resented by U.S. critics who say that Switzerland's dealings with the Nazis—specifically, acting as their banker—prolonged the war. "A lot of Swiss feel unfairly treated, and Mr. Blocher expresses that feeling," says Thomas Borer, Switzerland's special ambassador on issues relating to its wartime role. Although Blocher's party polls only about 15% of the Swiss vote, his folksy eloquence—and personal fortune—give him enormous power in Switzerland, where major issues are decided by referendum.



PROVOCATEUR?
If Blocher succeeds in blocking the reparations fund, Swiss businesses could be hurt

But if Blocher succeeds in blocking the reparations fund, "he may cause action against Switzerland that will not be to our advantage," worries one banker.

Blocher achieved his power by sheer persistence. A pastor's son from the native German-speaking heartland, he grew up poor, one of 11 children. He worked his way through college, in the process coming friendly with the founder of a small chemical company, and not many years after graduation became one of its top executives. In 1983, after the founder died, Blocher pulled off a management buyout.

Today, Blocher is one of Switzerland's

'I THINK THAT THIS IS BLACKMAIL'

On June 26, Christoph Blocher discussed his political views with *BUSINESS WEEK* Frankfurt bureau chief Thane Peterson.

Q: You're essentially a businessman. Why also be a politician?

A: Because I'm an independent indus-

trialist, I can bring a different point of view to politics. I think it's important to have entrepreneurs in Parliament, because politicians like to collect taxes and spend money, and entrepreneurs have to work for their money and pay taxes.

Q: Why were you against Switzerland associating with the European Union?

A: The EU is a very centralized, bureaucratic organization that likes to spend a lot of money and wants everyone to live in the same way. Switzer-

land has grown strong through market and free trade.... We have relations with the EU, but with America and Asia. Plus, in Brussels, the decisions are made in Brussels, the decisions can no longer be made in Switzerland. More and more of Switzerland's direct democracy will be lost.

Q: Let's talk about the Nazi gold question. Why are you so opposed to a \$5 billion fund to compensate victims of the war and others?

A: First of all, Switzerland did

Christoph Blocher

BORN

Oct. 11, 1940

EDUCATION

Law degree from University of Zurich in 1971

CAREER

Started working for EMS-Chemie while a student and took top job in 1984. His 23% stake in the company is worth \$500 million

PERSONAL

Married since 1967, four children. Hopes one will eventually take helm of EMS-Chemie

POLITICS

A member of Swiss Parliament since 1979. Leader of the right-wing populist Swiss People's Party

AGENDA

Keep Switzerland neutral and out of European Union; prevent use of any public funds for paying war reparations

DATA BUSINESS WEEK



est men. He has built EMS-Chemie (ding into a powerhouse that earned 7 million on sales of \$650 million in 1996. With personal control of 23% of s's capital and 60% of its voting res, Blocher has a net worth on pa of around \$500 million. Short and dy-haired, he has an unassuming air. he entertains business guests at a usand-year-old castle on the Rhine l posts his provocative speeches on a b site (www.blocher.ch).

As an executive, Blocher is hard-nosed (adaptable, focusing his company on fitable niches in the mature chemical stry. EMS-Chemie is tops in Europe in omotive undercoating, supplying near-every carmaker. In April, Blocher ed a joint venture with a major rival, Paul (Minn.)-based H. B. Fuller Co.

ket. In recent years, he has poured EMS's excess cash into the shares of big Swiss drugmakers. In 1996, earnings from these investments generated nearly half of EMS's profits. Early this year, fearing a market correction, Blocher liquidated EMS's equity positions and plans to put much of the cash into a \$223 million share buyback. As a result, figures Meinrad Gyr, an analyst with Zürcher Kantonalbank, EMS will earn \$299 million on sales of \$719 million this year—a margin of 42%.

D'AMATO FURIOUS. But Blocher's success doesn't impress his critics in the U.S. Senator Alfonse M. D'Amato (R-N.Y.), one of many American politicians who support the World Jewish Congress in pressuring the Swiss to make reparations to Holocaust survivors, is furious

Analysts think the deal will boost EMS's prospects as an automotive supplier on both sides of the Atlantic.

Blocher is also a savvy player in the Swiss stock mar-

that Blocher continues to refer to such pressure as "blackmail." Says D'Amato: "It is a shame that Mr. Blocher would impose his narrow-minded prejudices when it comes to righting the past wrongs against humanity."

Although Blocher insists he is no anti-Semite, his language sometimes raises hackles. In his interview with BUSINESS WEEK, he used the German word *Handlanger*, meaning helper or accomplice, to describe D'Amato's relationship with the WJC. "That's pure anti-Semitism," says Elan Steinberg, the WJC's executive director. "Switzerland received some \$3 billion in gold that the Nazis looted from throughout Europe. My question for Mr. Blocher is: What does he intend to do about it?"

If the fight keeps escalating, U.S. politicians and investors could revolt against Swiss banks and businesses. Blocher's political argument is that the Swiss should not bow to the wishes of foreign interests. But his country may pay dearly if he prevails.

By Thane Peterson in Zurich, with John Parry in Bern and Joan Warner in New York

t in World War II. Our army tral policy kept the Germans rading. Another reason is that groups of people in New York take money from Switzerland. ork Senator Alfonse] D'Amato as a helper to the World Congress, Mr. [Edgar] Bronf- e. They have accused Switzer- l said that we must pay. And ve don't pay, they threaten itzerland's reputation will be d. I think that this is black-

Q: When you say what you said about the World Jewish Congress, you sound like an anti-Semite. In the U.S., people may think you are.

A: I'm no anti-Semite. You can be sure of that. I'm against blackmail, be it from a Jew, a Muslim, a Christian, or a nihilist. No one has the right to blackmail a country. It is not the Jews in general who are doing it. It is an organization, and that is something entirely different. For me, an anti-Semite is someone who has contempt for Jews because of their religion, their culture.

That I am not. I reject the demands of the World Jewish Congress not because they are Jews, but in spite of the fact that they are Jewish.

Q: Why risk offending people when your company is expanding in the U.S.?

A: I love Switzerland. And I'm for what's right and just. And I believe that the majority of Americans, as far as I know them, respect that. If people are always afraid of the disadvantages [of speaking out], no one will take the risk of fighting for what is right.

COMMENTARY

By Joyce Barnathan

HONG KONG: SO FAR, TUNG IS MAKING ALL THE RIGHT MOVES

On July 1, 1997, the day China assumed sovereignty over Hong Kong, the territory's new rulers set the harbor ablaze with a flotilla of 31 illuminated barges, a laser show, and dazzling fireworks. The 800,000 spectators looking on, myself included, couldn't help but be wowed. But I also felt a sense of unease, wondering how well Hong Kong's new masters would fare at the daily, demanding job of governing. It was an easy task for Hong Kong's tycoons to foot the bill for the ceremonies and feasting surrounding the handover. But how will these magnates, who will now set the course for Hong Kong, improve on the British, who helped create a vibrant laissez-faire economy and free society in the shadow of communist China?

Of course, it's too early to tell how Hong Kong will develop. But in the past few days, I have detected encouraging signs, especially in the behavior of Hong Kong's new leader, Chief Executive C. H. Tung. By nature, the 60-year-old Tung feels more comfortable with the patriarchal style of Singaporean leader Lee Kuan Yew, and he has the conservative values one would expect of a successful businessman who has made millions in shipping. But when he stepped into the international limelight during his first major address after the handover, Tung emphasized democracy over control, freedoms over censorship. In the presence of China's top leader, President Jiang Zemin, Tung declared: "Democracy is the hallmark of a new era for Hong Kong."

In the first major test of free speech in the new era, Hong Kong's new government also let China critic Martin Lee deliver a sober address from the balcony of the Legislative Council on July 1. "My wish today is that our country, China, will become a great nation where the right of every single citizen will be protected by law," he told a cheering crowd of

5,000. If Tung keeps letting Lee protest this way, Lee will have one less thing to protest.

Tung's next challenge is to balance the interests of Hong Kong's people with those of his inner circle, wealthy professionals and tycoons such as property billionaire Li Ka-shing. For now, Beijing is comfortable with a Hong Kong run "of, for, and by Big

means he must complete his own transition from tycoon to politician.

Whether he would admit it or not, Tung has probably already learned much about the art of politics from his predecessor, former Governor Chris Patten. Vilified by Beijing and tycoons alike, Patten nevertheless set the benchmark for democracy and political discourse in Hong Kong.

For five years, he held a live seminar on how a politician operates. I recall the delighted crowds when Patten first ambled through the streets of Hong Kong in 1992 to pump the flesh and kiss babies. He never missed an opportunity to needle Beijing. But this shrewd Tory also emphasized accountable government and ran a transparent operation.

HANDS-ON. While Tung isn't as accessible as Patten, he is far more accessible than most British governors ever were. During his campaign to be selected as chief executive, he visited one community after the next to learn about their concerns, just as Patten worked his way through Hong Kong's neighborhoods to stir up support. In recent months, he has also given a steady stream of interviews and held press conferences with greater ease than when I first interviewed him last December. He still needs to sharpen his political skills to explain Beijing's behavior to the West and to Hong Kong itself. But a key aide, who had been concerned about Tung's stiffness, is now delighted with his progress.

Tung has been frustrated while waiting for the big day to arrive. Now, it has come and gone—and he can finally swing into action. "For the first time in history," Tung proclaimed, "we, the people of Hong Kong, will be master of our own destiny." Tung and his fellow citizens seem eager for the challenge.

Barnathan is BUSINESS WEEK's Hong Kong bureau chief.



ALL SMILES: Enjoying the handover holiday

Business," as Burton Levin, former U.S. consul general in Hong Kong, said at a conference sponsored by the U.S.-based Freedom Forum. Top Chinese leaders don't want to see Hong Kong squander the \$64 billion in foreign reserves it accumulated under British rule any more than Tung does.

Yet in coming months, populist groups, be they pro-Beijing or members of the Democratic Party, will press to spend much more of this wealth on social welfare. As these competing interests emerge, Tung will need to win public support, which

GROUNDSWELL: The candidate at the campaign's final rally



MEXICO

UNCHPAD OR THE PRESIDENCY?

Mexico City's mayor, Cárdenas will face a huge task

ver breakfast at an exclusive country club in southern Mexico City, 115 businesspeople listened intently to the populist politician Cuauhtémoc Cárdenas. He described how he would run the city. On July 6, polls say, he will win the election for mayor of Mexico City, the world's fourth largest. His audience expected was strident, with rich-vs.-poor rhetoric and tax-and-subsidy proposals. What they heard, instead, was Cárdenas' prescriptions for improving mass transit to unsnarl traffic, and encouraging electric cars and a new industry to improve the air.

Cárdenas, twice-defeated in presidential bids as a populist, has reinvented himself as a moderate. If his strategy wins him the mayoralty—Mexico's most prestigious post after the presidency—he intends to build a power base in the capital for his center-left Party of the Democratic Revolution (PRD).

NOT OF CHAOS? The city is an ideal launching platform for another run for president three years hence. "Whoever wins this election, if he does a good job of governing the city, it will be reflected in the elections in 2000," says Cárdenas. He will also have to show that the city is a constructive force, not the hotbed of chaos that politicians of the ruling Institutional Revolutionary Party (PRI) have often painted it to be. If he succeeds, he will help move Mexico toward a multiparty system after nearly 60 years of PRI one-party rule.

At 63, Cárdenas, the son of revered nationalist President Lázaro Cárdenas, is viewed by Mexico's political and business Establishment with a mixture of curiosity and alarm. His opposition to the PRI's embrace of free-market reforms led him to bolt the party in 1987 and form what became the PRD. But he has the legitimacy of a tireless promoter of democracy, and even some young businesspeople intend to vote for him to help pry the corrupt PRI from power. In the latest polls, Cárdenas holds more than 20-point leads over opponents Alfredo del Mazo, an old-guard PRI politician, and Carlos Castillo Peraza of the center-right National Action Party (PAN).

Although he has toned down his former populist appeals to workers and peasants, Cárdenas still worries some businesspeople because of positions he has taken. He has called for changes in the North American Free Trade Agreement to make it more favorable to Mexico and has assailed the creation of privately managed pension funds. But Cárdenas supporters who packed the Zócalo, Mexico City's central square, on June

28 for his last rally, see him as their best hope for a cleanup of Mexico's political system. "Corruption will end," predicts Antonio Mares, 45, a chemical salesman who attended the rally with his wife and teenage daughter.

In nationwide elections on July 6 for the lower house of Congress, the PRD and the PAN may win enough seats to force the PRI government of President Ernesto Zedillo Ponce de León to negotiate new policies rather than just ram them through the legislature as in the past. But the Mexico City race has dramatized the country's political ferment. With

8.5 million people in the Federal District, as the capital is called, and an equal number spilled into adjoining states, the city wields a potent influence in the country's affairs.

SHAKEDOWNS. Expectations that Cárdenas can make quick progress on intractable urban ills from crime to air pollution are bound to be disappointed. Fortunately for him, long-suffering *chilangos*, as Mexico City residents are nicknamed, are likely to be pleased by even modest reductions in corruption, from police shakedowns to the plague of 90,000 street peddlers, whose militant unions support the PRI in return for protection from official crackdowns.

San Lorenzo Tezonco, a maze of crooked potholed streets on the city's outskirts, is the kind of neighborhood that will test Cárdenas' prospects. It is poor and also a model for the kind of grassroots organizing that the PRD has carried out for years. Residents lay their own water lines, cook at a community kitchen, and volunteer at the local day-care center. Cárdenas hopes to expand such efforts citywide to show that much can be done with limited municipal resources.

What has pushed usually conservative Mexican voters to risk change is the sentiment that government corruption must be uprooted at all levels. Although this process may take a generation, it's beginning now. Cárdenas' mission is to identify himself, and his party, with this political groundswell.

By Geri Smith, with Elisabeth Malkin, in Mexico City

WHAT A CARDENAS WIN WILL MEAN TO MEXICO

- ▶ With the opposition leader as mayor of Mexico City, the ruling PRI is deprived of a key source of power and patronage
- ▶ By moving his populist PRD party closer to the political center, he is broadening its nationwide appeal
- ▶ With the capital as a highly visible platform, Cárdenas will be a top contender for the presidency in 2000

DATA: BUSINESS WEEK

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EDITED BY JOHN TEMPLEMAN

NATO'S NEW MEMBERS: THEIR EYES ARE ON THE BIGGER PRIZE

Central Europeans will have reason to party when NATO leaders meet in Madrid on July 8-9. Nearly eight years after the fall of the Berlin Wall and the end of the cold war, at least three former Warsaw Pact members, Poland, Hungary, and the Czech Republic, will be invited to become NATO members. For them it is proof positive of their acceptance into the elite club of Western democratic nations. The celebrations may be premature.

The danger now is that, having addressed Central Europeans' security worries through NATO, the Western Europeans might feel under far less pressure to admit them to the European Union. "There is no question that NATO expansion is a consolation prize," says Michael Mandelbaum, director of the Council on Foreign Relations' project on East-West relations.

EU entry is far more important for Central European nations than NATO membership. It brings privileged access to the rich markets and to its development funds for poor members. For the 10 former Soviet-bloc nations that have applied to the EU, such access could sustain the rapid growth they need to underpin, and pay for, their security.

DISASTER FOR POLAND. The Central Europeans have no intention of being palmed off with NATO membership. "To say we are part of the West now and to give up membership on the EU would be a disaster for Poland," says Andrzej Reiter, a former ambassador to Germany who now works at Warsaw's Institute of Public Affairs.

But domestic pressures on EU nations are such that their members have a growing interest in slowing down the admission of new members. Their economies are reeling from unemployment rates averaging 10.8%, slow growth, big budget deficits, and huge debt burdens. And they need to step up austerity in the scramble to meet harsh criteria for joining

the EU's single-currency bloc, due to start in 1999.

A big influx of new members would force existing EU members to pile on the agony with another wave of painful budget cuts or even heavier taxation. Already, large-scale handouts to EU farmers and poor countries account for more than 80% of the EU's \$81 billion annual budget. By some estimates, admission of all 10 wannabes would, absent reforms, quickly double EU budget outlays.

No EU leader is willing to hit taxpayers for yet more cash to send to Brussels. But slashing outlays would quickly create new fault lines inside the EU since budget cuts would fall unevenly. France and other big recipients of farm subsidies, for instance, would fight to keep their benefits. And countries such as Ireland and Spain resist having to surrender all or most of their so-called structural funds, which are basically handouts to help poor countries raise per capita income levels to EU averages.

NOT AUTOMATIC. It's not that wily Western European leaders set out to sucker Central Europeans with a cynical bait-and-switch tactic. "To say it's intentional would assume a level of nastiness that does not exist," says Karl-Heinz Kamp, head of foreign and security policy at the Konrad

Adenauer Foundation in Bonn.

Indeed, at their Amsterdam summit in June, EU leaders took some of the technical steps required to enable the 15-nation group to admit five new members eventually. Later this month, EU negotiators will issue a status report on each of the 10 applicants. Entry talks are due to begin early next year.

But there's nothing automatic about admission. Turkey, a NATO member since 1952, is still waiting at the EU's door.

By Karen Lowry Miller in Frankfurt, with Stan Crock in Washington



EU LEADERS: Troubles of their own

GLOBAL WRAPUP

THAILAND'S SHOCK THERAPY

The Bank of Thailand rocked financial markets on July 2 by floating the baht and raising the discount rate by 5 percentage points, to 12.5%. By day's end, the Thai currency had skidded 17% from its former fixed rate of 20 baht to the dollar, while the stock market soared nearly 8%.

The shock treatment came not a moment too soon. The Thai economy has been reeling for months, racked by 16 failed financial institutions and untenable fixed currency rates that threat-

ened to clean out the central bank's reserves, which shrank by about a third, to \$23 billion, last month.

The bank's bold moves should pay off soon. Analysts say export growth should accelerate to 8% this year from earlier estimates of 7%. The balance-of-payments deficit could fall by a quarter, to 6% of gross domestic product.

But there are big losers, especially among already fragile companies in the key petrochemical, steel, real estate, and finance industries. They used cheap foreign currency loans from Thai and foreign banks to fund overrapid

expansion. They are now more than \$70 billion in hock. Worse yet, most never bothered to hedge their huge foreign currency exposure because the baht was fixed against a currency basket 80% composed of U.S. dollars.

The worst hit companies, however, have huge political clout. They are big financial backers of every political party in Thailand's parliament. So if they lobby for special favors, the central bank's shock therapy may never be allowed to run its course and restore the country to full economic health.

By Michael Shari in Bangkok

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PHOTOGRAPH BY JEFFREY M. HARRIS

ALAN GREENSPAN'S BRAVE NEW WORLD

By all conventional indicators, an interest-rate increase should have been a sure thing when the Federal Reserve's Open Market Committee (FOMC) met on May 20. As the 17 central bankers settled around the immense mahogany table in the Fed's conference room, they faced an economy growing at nearly 6% and an unemployment rate below 5%—a level that for the past quarter-century has been a near-cer-

tain signal of impending inflation. Indeed, most officials at the meeting seemed to favor hikes. Robert T. Parry, the inflation hawk who heads the San Francisco Fed, worried about the low jobless rate. Richmond (Va.) Fed President J. Alfred Broaddus Jr. fretted that inflation could rise if the Fed didn't act. And Fed Governor Laurence H. Meyer—one of the nation's top forecasters—believed that growth was too strong to be sustainable. But after a coffee break, when the group reconvened to decide whether to raise rates, Fed chairman Alan Greenspan exercised his prerogative to talk first. Speaking from the head of the table in confident, low-key tones, he argued that there was no need for higher rates, noting that the economy showed signs of slowing. More important, he insisted that his colleagues, years of heavy spending on new technology finally could be yielding big productivity gains. When the final votes were cast, the verdict was overwhelmingly unanimous: no rate increase. Only Broaddus dissented.

This decision was no one-time aberration, as the next FOMC meeting, on July 2, revealed. Armed with an extra month's data showing a slowing economy and a lack of inflationary pressures—but without having seen the June employment report due out the next day—Greenspan once again carried the day. The FOMC voted to keep rates steady.

As he approaches his 10th anniversary as chairman of the Fed on Aug. 11, Alan Greenspan finds himself in the unlikeliest of positions: The staunch conservative who once personified industrial-era economic thinking has turned into the avant-garde advocate of the New Economy. "He is very open to the possibility that we have entered a new economic age," says Judy Shelton, a conservative scholar who meets with the Fed chief several times a year. "He really believes in the organic nature of the market economy."

Cover Story

He's not scared by faster growth. Why? Because productivity gains are keeping inflation in check

President Clinton shares Greenspan's view on the New Economy. He told BUSINESS WEEK on July 2: "I believe it's possible to have more sustained and higher growth without inflation than we previously thought" (page 48).

Such are Greenspan's success and prestige that he has been able to carry the FOMC into uncharted territory—by allowing faster growth and lower unemployment than the Fed would have permitted in the past. According to Fed insiders, at no fewer than four FOMC meetings in the past 18



JUST MARRIED: Andrea Mitchell, an NBC correspondent, became Greenspan's wife in April, 1997

months, Greenspan has prevailed over colleagues who wanted a more restrictive policy. Today, "he rules the room," observes former Fed Vice-Chairman Manuel H. Johnson. "Until he makes a big mistake, he'll continue to get everything he wants."

It has been a remarkable odyssey for the 71-year-old New Yorker who is guiding the economy through the best times it has seen since the 1960s. After all, the former Ayn Rand devotee spent 30 years as a nuts-and-bolts industrial economist. And in his early years at the Fed, Greenspan was known as the central banker

Cover Story

who kept money tight to counter a big-spending government and stamp out inflation. It was an image the Fed chief seemed to relish: Displayed in his office is a framed cartoon from the Bush years that shows him as an economic Cassandra holding up a sign that proclaims: "The end is near."

Today, a more unconventional portrait of Greenspan emerges from conversations with dozens of friends, Fed colleagues, and Washington insiders. The Fed boss is becoming more willing to test his thesis that the economy is operating very differently than it did in past business cycles, lessening the risk of inflation. "There is a sense in which [Greenspan] is the extreme dove," says one Fed source. "He has been willing to let the economy run tighter than what a lot of people have been comfortable with. It's not uncommon to have a meeting where everyone disagrees with him, but goes along with him in the end."

Greenspan is even showing a softer side these days, talking privately about the social benefits of a low jobless rate—that a whole generation of previously unemployable workers can build skills to carry through life. That's not a concern you would have expected to hear from the man who, as chief White House economist during the recession of 1974-75, created a furor by suggesting that stockbrokers were suffering more from the downturn than the poor.

Greenspan, who hasn't given an on-the-record interview in

Ten Years At The Fed

JUNE 2, 1987

Paul A. Volcker resigns as chairman of the Federal Reserve, and Reagan nominates Alan Greenspan for the post. Wall Street praises Greenspan as an inflation fighter.



AUG. 11, 1987

Greenspan sworn in as Fed chairman.



six years, would certainly take offense at any suggestion that he's anything less than an anti-inflation hawk: Indeed, if the economy grows too fast in coming months, he could be quick to raise rates. In conversations with confidants, the Fed chief insists that his core values haven't changed since President Reagan named him Fed chairman in 1987. Back then, Greenspan was willing to err on the side of higher interest rates to keep inflation from spiraling out of control again. Twenty years ago, with the budget deficit soaring and an inflation's chology still widespread, he feared that any letup by the Fed could quickly lead to a new round of rising prices.

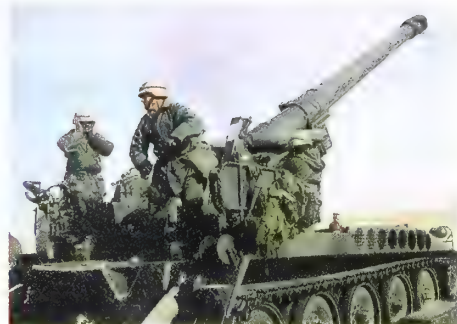
But the Fed chief argues that while his goals are still the same, the economy is not. In Greenspan's brave new world, heightened global competition is restraining U.S. wage growth and limiting companies' ability to pass along higher costs. Corporate America's massive investment in computer and other labor-saving technologies may be boosting productivity far above the measured rate—letting the unemployment rate drop without triggering inflation. And while corporate downsizings may be slowing, Greenspan nonetheless believes the aftershocks may be felt a little longer—as workers continue to value job security more than higher wages. **SKEPTICISM.** What's more, the Fed chairman is reaping the results of successful deficit reduction, something he has been advocating for decades. Without additional stimulus from private government spending, the Fed can afford to ease up on the monetary restraint it had to apply during the megadebt 1980s and early 1990s. And Greenspan is convinced that the financial markets—which can react instantaneously to developments—are now playing much of the Fed's old role of stimulating or restraining the economy. That puts the central bank in the enviable position of simply playing referee—guiding nudging rates up or down to prod the markets to do its work.

Greenspan's new vision generates skepticism among present and past colleagues, who are reluctant to toss out economic models that have worked in the past. Some, such as Me



AUG. 8, 1988

Rising inflation and tight labor markets lead the Fed to raise the discount rate a half-point, to 6.5%, on the eve of the GOP convention—a move that infuriates soon-to-be President George Bush.



AUG. 2, 1990

Iraqi troops invade Kuwait, interfering with Greenspan's attempt to engineer a soft landing for the economy.

publish his credentials as a politician, Greenspan raised the discount rate up a percentage point.

OCT. 19, 1987

The stock market drops 508 points. Greenspan reacts by opening the monetary spigot to flood the markets with liquidity. He also ensures that brokerage firms are getting the credit they need.



former Vice-Chairman Alan S. Blinder, believe that even today's economy, inflation is apt to accelerate if the unemployment rate falls below a critical level—pegged around 5.5%. Other Fed officials doubt that the productivity gap is as large as Greenspan thinks.

The Fed chief, by contrast, feels freer to change his mind about economic trends because he's influenced less by academic models than empirical data. In fact, Greenspan didn't get his PhD in economics (from New York University) until 1977, after he had served as chairman of the Council of Economic Advisers under President Ford.

Instead, Greenspan combines an eclectic approach to economic analysis with a love of statistical minutiae. As a young analyst and later as an economic consultant to such firms as Burlington Industries Inc. and Ryder System Inc., he used a "bottoms up" approach of looking at thousands of pieces of data to draw broader conclusions about the economy. Even when he assumed control of the Fed, he had political advisers to weigh in as well as economists. According to former colleagues, he was fearful that his close ties to the Republican White House—which had drafted him to head a 1983 Social Security reform commission—would impair his credibility with Wall Street. Recalls one former associate: "Alan did not want

to be viewed as another Arthur Burns," the Nixon-appointed Fed chief who some blame for letting inflation spiral out of control in response to White House demands for faster growth.

To signal his independence from the Reagan White House, Greenspan engineered a sharp rate increase at his first FOMC meeting—a move that critics believe contributed to the Oct. 19, 1987, stock market crash. But he quickly won kudos on Wall Street and in Washington for his calm handling of the crisis: The Fed chief headed off a full-blown panic by promising that the Fed would provide as much liquidity as needed to keep the nation's financial institutions solvent.

SNIPING. Any praise for Greenspan from the White House soon died down, however. On the eve of the GOP convention in the summer of 1988, the Fed raised interest rates, upsetting GOP Presidential nominee George Bush and foreshadowing four years of sniping from the Bush Administration.

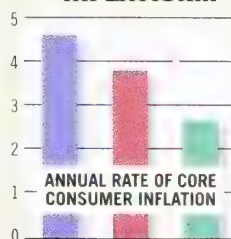
Fed watchers say Greenspan wasn't trying to distance himself from Bush so much as responding to what he perceived as growing inflationary pressures. But Greenspan overestimated the strength of the economy in the early 1990s and was too slow to lower rates after Iran invaded Kuwait and consumer confidence plunged. The result: a recession and the most sluggish recovery in modern times. To some Bush officials, Green-

HE GREENSPAN RECORD

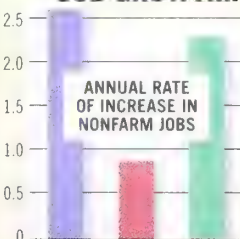
FIRST THREE YEARS
(1987 11Q - 1990 11Q)
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(1990 11Q - 1994 11Q)
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(1994 11Q - 1997 11Q)

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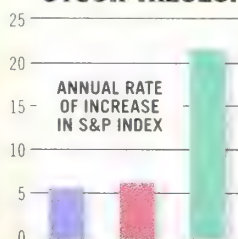
FALLING INFLATION...



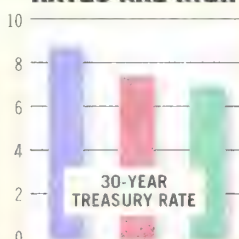
...STRONG JOB GROWTH...



...RISING STOCK VALUES...



...BUT INTEREST RATES ARE HIGH





JULY 10, 1991

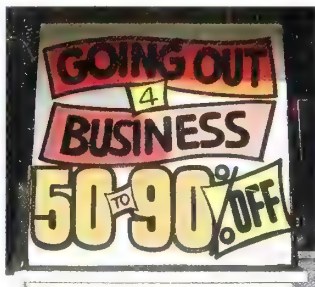
Despite bitter feelings between the Federal Reserve and the White House, Bush nominates Greenspan for a second term to avoid roiling the markets.

FEB. 4, 1994

After keeping the Fed funds rate steady for a record 18 months, Greenspan leads the Fed in a "preemptive strike" against inflation by raising the rate one-quarter point. The Fed also makes history by publicly announcing a rate move for the first time.

DEC. 19, 1991

With the economy in the doldrums, the Fed votes to slash the discount rate a full percentage point, to 3.5%. Fed officials hope the bold move will jump-start growth.



span's anti-inflation zeal caused the President's defeat in 1992.

Nowadays, Greenspan relies largely on the accretion of detail to draw his conclusions, although he has never given up on finding a magic compass for directing policy. Among his favorite indicators are inventory levels, supplier delivery times, and a measure that relates wages and benefits to productivity.

Greenspan has even developed his own private data sources. At his behest, the National Association of Home Builders now conducts a proprietary survey of its largest members to give the Fed an early and more detailed look at housing construction.

Cover Story

And each month, General Motors Chairman John F. Smith talks with Chicago Fed President Michael H. Moskow, who conveys information directly to Greenspan. "Jack gives him our sense of where sales are headed," says G. Mustafa Mohatarem, chief economist at GM. **"SCREW LOOSE."** In his 10 years at the Fed, the number of data series the research staff tracks has tripled, to more than 14,000. Included are about two dozen proprietary series, such as an elaborate inventory-tracking system developed by Greenspan that, Fed insiders joke, only he understands. After banding together with other governors to demand access to Greenspan's inventory system, former Fed Governor Janet L. Yellen—who left earlier this year to become President Clinton's chief economic adviser—chuckles: "I decided I didn't want to understand it. It was so complex that it was beyond me."

Still, Yellen and other colleagues concede that Greenspan's obsession with detailed economic data often allows him to spot, and then frame, critical economic forces long before others do—such as the credit-crunch-induced "headwinds" that delayed the recovery in the early 1990s. And when he launched his controversial "preemptive strike" against inflation in February, 1994, he defied critics who predicted that he would trigger another recession in an attempt to stamp out inflationary pressures they didn't see. Instead, he pulled off a soft landing that has resulted in one of the longest expansions in history.



IAN. 31, 1995

Greenspan lends his support as the White House cobbles together a \$50 billion international rescue of the Mexican peso.

FEB. 1, 1995

The Fed raises the funds rate a half-point, to 6—the last of seven tightening moves begun the year before. This move is meant to send a signal to Wall Street that the Fed is reaffirming its fight against inflation.



JULY 6, 1995

Amid fears of a coming recession, the Fed cuts rates a quarter-point. More quarter-point cuts follow, in December and January.

Often, Greenspan is so far ahead of the curve that he tentatively plays to doubting audiences inside the Fed. "When I started talking about 'worker insecurity' in 1994, there was a lot of people on the FOMC who thought he had a sense of loose," recalls one Fed official. And some Fed insiders rue that, while Greenspan's penchant for citing obscure data sources often helps sway FOMC members, some of those indicators prove inconclusive upon further review.

Yet Fed officials agree that over time, Greenspan is more often right than wrong. "I give him credit for discerning some of these developments sooner than I do," admits Bradus. Such sentiment explains why the FOMC members are increasingly willing to overlook their own doubts and put much faith in Greenspan's instincts.

In January, 1996, Greenspan was in the minority in his desire to cut interest rates for a third—and last—time to shore up the softening economy, but the other board members went along with him. Then last July and September and

CLINTON AND GREENSPAN: THE ODD COUPLE

In a July 2 phone interview with Washington Correspondent Dean Foust and Senior News Editor Owen Ullman, President Clinton joked that he and Greenspan are "the odd couple," adding: "I think he has done a fine job." Other than that, on their personal chemistry: "I've enjoyed our relationship. I try to see him a few times a year because he has a lot of data about the economy. He processes it very quickly and he's always got an interesting take on it."

■ On good relations with the Fed: "I think it's because he has defended the independence of the Fed. Even though

J. 22, 1996

the Senate in GOP hands, Clinton has little choice but to nominate Greenspan for a rare third term. The chairman is confirmed and sworn in on June 20.



DEC. 5, 1996

In a Washington speech, Greenspan wonders aloud whether the stock market is suffering from "irrational exuberance." After a short-term drop, the market recovers and zooms ahead to new records in the spring.

MAR. 25, 1997

Greenspan nudges the Fed funds rate up a quarter-point, to 5.5%. He calls the move an "insurance" policy—in case inflation should unexpectedly break out.

FEB. 24, 1996

Clinton Budget Director Richard Rivlin takes office as vice-chair, replacing Robert Blinder. Rivlin plays a key role in supporting Greenspan's efforts to fend off calls for higher rates to cool a surging economy.

SEPT. 24, 1996

For the second time since July, Greenspan fends off a call by Fed hawks, who want to raise rates as much as a half-point. He argues that there's little threat of inflation exploding.



JULY 2, 1997

The FOMC opts, for a second straight meeting, to hold rates steady even though unemployment had reached its lowest level in 25 years.

DATA BUSINESS WEEK

May, while many FOMC members were itching to raise rates, they bowed to Greenspan's request to wait for more definitive data before acting. Only on Mar. 25 did the chairman consent to a modest quarter-point snugging, justifying it in an "insurance policy" in case his forecast of a slowing economy proved wrong. In later weeks, as new data bolstered his outlook, he privately boasted that a year from now, even the March hike might look unnecessary in hindsight. **HE SANGUINE.** Surprisingly, given his reputation as a data skeptic, Greenspan has shown a profound willingness to go beyond the official statistics. For one thing, he thinks the economy is close to true price stability—taking into account his belief that government figures overstate the real rate of inflation by as much as 1.5%.

More significant, Greenspan argues that the U.S. is undergoing a productivity revolution not seen since early this century. Although BLS measures of productivity remain stuck around 1%, Greenspan believes that statistical distortions

are understating efficiency gains. Admits one uncertain FOMC colleague: "You can't give me a better story that ties up so many loose ends."

So confident is Greenspan of his argument that he has required researchers to make a second productivity measure by "zeroing out" any industry sector—such as health care—where statistics show falling productivity. Reason? In this cost-cutting era, he can't fathom any sector becoming less efficient. Still, these exercises drive researchers nuts. "A lot of the staff are skeptical of overmining the data," says Governor Susan M. Phillips. "They'll complain about it, but in hindsight, it has made a lot of sense."

The suspected productivity payoff is also making Greenspan more sanguine about the rising stock market. When he raised his famous concern last December about whether stocks were in the grip of "irrational exuberance," the Fed chief was worried that corporate profits couldn't keep pace and that a steep correction might ensue. But margins have been rising smartly—faster than Greenspan can ever recall. His only explanation: productivity.

The technological revolution has a disadvantage for Greenspan and his Fed colleagues: Given that much of the government's data-collection was designed to track the old manufacturing-driven society, the changes engendered by the computer are making it harder for the Fed and other economic forecasters to follow the new information economy. And the problem will only get worse in coming years, as the central bank struggles to find accurate measures for output and inflation as well as productivity.

If Greenspan keeps adapting and his good fortune in steering the economy holds until his term expires in June, 2000, he will have set the record for the longest expansion in U.S. history, surpassing the 1961-69 boom that legendary Fed Chairman William McChesney Martin presided over. And if the good times are still rolling come the turn of the century, Greenspan just might win another four-year term. Certainly many associates think he would be interested, if his health

from different political backgrounds, he knew we were about reining in the deficit."

New Economy: "The globalization of our economy, use of technologies, improved management, increased productivity, and a greater sophistication among working people—the relationship between their incomes and the profits of their companies—all are giving us greater capacity to grow. A lot is coming through productivity that so far we haven't been able to easily measure."

Greenspan's chances for reappointment in 2000: "I've made it a practice not to discuss appointments before they come up. We've got a Federal Reserve that has been disciplined on inflation while permitting more growth. Economic policy has moved away from trickle-down to an invest-and-cut-and-grow strategy. All those things are done, and he deserves a lot of credit."

holds. And why would Clinton want to mess with success?

The Fed chief's job has been made easier by his close working relationship with the Clinton Administration, which has adopted a policy of never second-guessing Fed policy. Treasury Secretary Robert E. Rubin, a longtime acquaintance, recalls de-

Cover Story

liberating with deputy Lawrence H. Summers last year about whether to float inflation-indexed bonds. "We had a very technical issue we needed to get a judgment on," says Rubin. "We called Alan because he has a lot of market savvy and good sense."

Greenspan's relationship with President Clinton himself has taken a bit longer to jell. Early in Clinton's first term, the relationship was cool: White House aides say Clinton threw purple fits when Greenspan raised rates seven times between

1994 and 1995. But the subsequent soft landing paved the way for Greenspan's reappointment in March, 1996—and Clinton's reelection eight months later. That was a sure way for the chief to endear himself to Bill Clinton. "The President really likes Alan. Greenspan is an acquired taste," says one top aide. Indeed, last winter when Clinton was considering ways to raise Social Security, he consulted with Greenspan.

For now, Greenspan's primary concern is testing whether his productivity theory is true: He figures data over the next 12 months could be telling. In the longer term, he is betting that as the world moves into the 21st century and the New Economy takes root, more of the old economic rules will fall apart. That will require a shrewd central banker to figure out what's going on. And by all indications, Alan Greenspan wants to be a witness to that revolution.

By Dean Foust in Washington

THE CHAIRMAN AS POLITICAL ANIMAL

From his trademark black-rimmed glasses to his heavy use of oblique FedSpeak, Alan Greenspan looks like a nerdy economist lost in a world of heavy-truck production reports. Yet the Federal Reserve chairman's success derives as much from his shrewd reading of the political tea leaves as from his economic analysis. "He not only knows the numbers, but the music too," says longtime friend James A. Johnson, CEO of Fannie Mae Corp. "He has an innate sense for anticipating the political reactions before they happen."

As a child growing up in Manhattan's Washington Heights section, Greenspan had an obsession with, well, numbers and music. "He knew everyone's batting average in the Major Leagues," recalls cousin Wesley Halpert, a prominent New York dentist, who says young Alan was a nimble dancer and good musician. Greenspan studied briefly at the Juilliard School of Music in the mid-1940s before touring the country playing bass clarinet in Henry Jerome's swing band. Now friends occasionally coax him to improvise a little jazz piano after dinner. **RAND FAN.** By his mid-20s, Greenspan turned from music to economics—and the virulently antigovernment views of philosopher-novelist Ayn Rand. Greenspan became a regular in her salon in the 1950s and remained in touch until her death in 1982.

In 1954, Greenspan formed the New York-based economic consulting firm of Townsend-Greenspan & Co., which he headed for 30 years. Even-

tually, though, Greenspan began spending more time in Washington, including serving as an adviser to Richard M. Nixon's 1968 campaign. In 1974, then-White House Counsel Leonard Garment, a former Henry Jerome bandmate, offered Greenspan the job of chairman of the Council of Economic Advisers. Although Nixon



NET GAIN? Greenspan is tough on the court, too

had resigned by the time Greenspan was confirmed, Ford kept him as CEA head. He returned to economic consulting after Jimmy Carter's election, but once Reagan took office he became a valuable White House adviser.

Although he professes to dislike the social scene and is awkward at small talk, Greenspan nonetheless is ubiquitous on the cocktail circuit. Why? To gather political intelligence. He also can be found on the tennis court or golf course with power brokers such as Arthur Levitt Jr., chairman of the Securities & Exchange Commission, and House Budget Committee Chairman John Kasich (R-Ohio).

A peek inside Greenspan's office

shows the extent of his political connections. On the walls are photos of him with Boris Yeltsin, Margaret Thatcher, and the four U.S. Presidents who have sworn him into office. The photo with Clinton is autographed: "Alan, here you are pointing LEFT—a new direction for you?" On Greenspan's bookshelves,

there are tomes on economics by the likes of Stanford University economist John B. Taylor and spines with political titles, including Bob Woodward's *The Agenda*—which treats Greenspan prominently and favorably.

Greenspan starts each day at 5:30 a.m. with a two-hour soak in the tub—a remedy prescribed by his doctor 25 years ago for a bad back. It's his most productive work time: He pores over countless memos and reports. "The unsung hero at the Fed is the assistant who has to read his waterlogged scribbles,"

jokes Andrea Mitchell, the NBC correspondent who married Greenspan in April after a 12-year courtship.

Despite his extensive networking, Mitchell says her husband is happiest spending a quiet night at home: "It's a close call whether the house will be filled with Vivaldi or the [Baltimore] Orioles." And friends say the 71-year-old Fed chief's recent marriage, his second, has brought out a new personal dimension. "There's been a noticeable element of spiritual renewal," says a close friend. Still, Mitchell says, work is never far from his mind. "The man just loves what he's doing."

By Dean Foust, with Owen Ullmann, in Washington

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TAKING THE ANGST OUT OF TAKING A GAMBLE

It's called value-at-risk management, and it's quickly moving into mainstream finance

In early 1994, trading operations of many big banks and brokerage firms discovered that they had accidentally put all their eggs in one basket. Sure, they had split their money between such assets as commodities, debt, and cash. But when interest rates shot up, they found that every asset class contained a built-in assumption that interest rates would fall. Debt was in long-maturity bonds; commodities were in holdings such as interest-rate futures that would appreciate if rates fell; even cash was sunk in "structured notes"—derivative securities that paid little or nothing if interest rates got too high. The result: one big splat.

Losses from that hidden concentration of risk helped convince the institutions that there must be a better way to handle risk—and now there is. It's a new risk-management methodology called "value at risk." The idea is to calculate—dispassionately and methodically—the amount of risk inherent in a financial portfolio at any given time. The method spits out a number, known as the value at risk, which is the most money a portfolio could possibly lose in, say, the next 24 hours with a level of confidence of 95%, for example. It looks at how risk exposures in different parts of a portfolio can either amplify each other or (happily) cancel each other out.

Value-at-risk techniques not only make sure that you're truly diversified and have adequate capital on hand.

They also tell you when you're leaving money on the table by being unnecessarily cautious. For those reasons, the techniques are moving into mainstream finance with startling speed. In 1994, they were used mainly by a handful of international banks and brokerage firms to manage risks on their trading desks. But now, VAR is expanding in two dimensions: It's being used for risks other

Trade Resources, the nation's biggest wholesale marketer of natural gas and electricity, calculates its VAR every day.

A major boost for value-at-risk methods came on July 1, when a benchmark for credit-risk management developed by J.P. Morgan & Co. picked up the endorsement of the world's two biggest credit-rating agencies as well as eight big banks and accounting firms. The

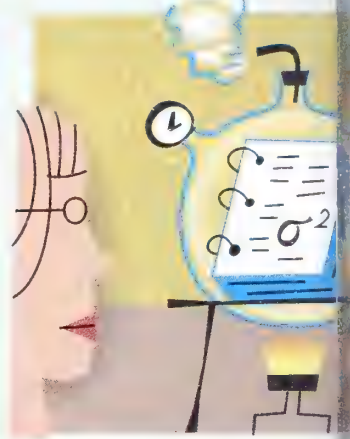
HOW TO FIGURE HOW MUCH IS AT STAKE

VAR is a measure of how much a company's net worth could shrink if things suddenly go wrong. Here's one way a big bank might use it in the near future:



1 Assemble a bankwide portfolio of current positions in all accounts, including ones that hedge each other.

"We own gold futures, Japanese yen forward contracts, and New York State Thruway bonds."



2 Calculate possible price swings, seeing how it would have performed on various days in the past.

"If I'd had this portfolio last September, it would have made \$1.5 million. In October, it would have lost \$15 million."

than market movements, such as the risk of default by the other party in derivative deals. And it's being used by people other than traders, including mutual-fund managers and even CFOs at nonfinancial companies, including Xerox, General Motors, Enron, and GTE.

HISTORICAL DATA. Some of the momentum comes from regulators, who see VAR analysis as a more efficient means of determining the amount of capital that firms, especially banks, should have in reserve against unexpected losses. But much of the push is from the companies themselves. Enron Capital &

benchmark, known as CreditMetrics, contains historical data about credit risks that can be plugged into computer programs that firms use to calculate their value at risk. It's linked to Isis Metrics, a benchmark for market-movement risk that Morgan introduced in October, 1994. Says James E. Satlin, managing director in charge of product development at Standard & Poor's Corp., one of the new CreditMetrics sponsors: "The combined analysis of credit and market risk is going to become one of the most important financial-management tools."

to be sure, the value-at-risk approach isn't protect against what's known as rational risk, ranging from outright fraud to costly clerical errors. While Merrill Lynch & Co. calculates its VAR, it puts more emphasis on sound personnel practices and structural checks and balances, says Daniel T. Napolitano, senior vice-president in charge of global risk management. "Once you've built your statistical models, there's a temptation to fall in love with them," says physicist John D. Breit, a managing director working for Napoli. "You're doing a lot of very smart people onto a head-on-the-head-of-a-pin' land." True enough, but the VAR technique is hanging on nonetheless because it does things that older risk-management methods cannot—such as discover "hot spots" of risk. If an operation is producing small profits yet requiring a big capital cushion because of its high VAR, it's likely to receive instructions to cut back or hedge. The beauty of VAR is that it allows for comparisons between business units that use different yard-

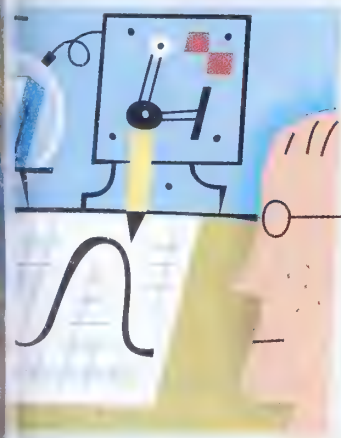
precise basis for setting capital requirements than traditional techniques, which ignore the opportunities for a portfolio to be internally hedged. On the other hand, there is no universally accepted way to calculate value at risk. Regulators have to take the word of firms that their rocket scientists have done their VAR math correctly.

BEYOND BANKS. Despite those qualms, the European Commission and the Basel (Switzerland) Bank for International Settlements, an advisory body, have cleared European banks to start using their own VAR models as the basis for calculating capital requirements starting in 1998. The Federal Reserve is postponing its own move to VAR as it considers an even more deregulatory approach. While the Europeans will be required to hold capital reserves equal to three times a conservatively calculated VAR, the Fed is studying whether to let banks decide for themselves how much capital to hold based on their VAR calculations—though they would be subject to fines and public disclosure if they

gages. They will need an accepted tool for making those calculations.

This is great news for the pioneers of value-at-risk analysis, including J.P. Morgan, Bankers Trust, Credit Suisse, and Deutsche Bank, which are selling their expertise. Bankers Trust Co. charges \$1 million for RAROC 2020, which shows the risk-adjusted return on capital for each element in a company's portfolio, as well as the exposure to each type of risk. "If you appear to be well-versed in risk management, you get to talk to the fancier clients," says Till M. Guldemann, an originator of J.P.

VAR can't be taken as gospel. Especially in times of turmoil



the portfolio's percentage or loss for hundreds of such

portfolio is a lot riskier than we

as for internal purposes, says Lev Odovsky, executive director of the Global Association of Risk Professionals in New York City. "You can really tell you've got more risk on the books." Value-at-risk calculations can't be taken as gospel. They're typically based on historical patterns that aren't always a good guide to the future—especially in times of turmoil. So most firms supplement the analysis by "stress-testing" a portfolio to see how it would perform in various worst-case scenarios. Although regulators like VAR, it poses a dilemma. On the one hand, it's a more



4 Figure the value at risk in each holding. Order traders that are overexposed to close out positions.

"Hey, commodity traders: You're too vulnerable to a big decline in gold prices. Bail out."

underestimated risk and their capital reserves proved insufficient.

VAR is going beyond banks. U.S. broker-dealers are voluntarily reporting daily calculations in anticipation of a new regulatory scheme for derivatives trading—much of which goes unregulated now. Also, the Securities & Exchange Commission may require all types of firms to report the estimated market value of derivatives on their balance sheets. One way is through VAR analysis. In the next decade, banks may be required to mark all assets to market on a regular basis—even ordinary loans and mort-



5 Report your bank's value at risk for a certain period to the Federal Reserve.

"Dear Fed: We estimate that there is a 5% chance our portfolio will decline \$20 million or more in the next two days."

Morgan's RiskMetrics who is now executive vice-president of Mountain View (Calif.) Infinity Financial Technology Inc.

For all its imperfections, VAR analysis is a disciplined method for tracking down sources of risk that might otherwise escape notice. Lisa K. Polsky, a Morgan Stanley & Co. managing director and chief derivatives strategist, likes to quote J.R.R. Tolkien: "It doesn't do to leave a live dragon out of your calculations if you live near him." VAR helps find those dragons.

By Peter Coy in New York, with bureau reports

THRIFTS

ENERGIZER BANKER

Washington Mutual's CEO is dealing as fast as he can

Kerry K. Killinger has always known exactly where he was going. As a securities analyst in his twenties, he moved his family into a mobile home to save money and spent evenings and weekends restoring rundown houses in Spokane. Selling one every two months for several years, he bought up a major stake in his employer, Murphey Favre Inc., a brokerage house in Spokane, Wash., then brokered a deal to sell it to Washington Mutual Inc., a Seattle thrift with \$2.7 billion in assets.

Fifteen years later, Kerry Killinger is still probably the banking industry's most manic executive. Working out of an office decorated with an oversize Energizer Bunny, the 48-year-old Killinger has built Washington Mutual into the nation's biggest savings and loan, with \$88.5 billion in assets. Over the past seven months, he has quadrupled the size of his thrift by paying \$1.7 billion for Irvine, Calif.-based American Savings Bank on Dec. 21, and then wrested Great Western Financial Corp. from hostile bidder H. F. Ahmanson & Co., closing the deal for \$8 billion on July 1.

CULT FOLLOWING. Shares of WAMU, as it is popularly called after its stock symbol, have increased 840% during Killinger's seven-year reign as CEO, beating the stock performance of every Western bank and thrift. Killinger's holding is worth \$67 million. He is already looking over the remaining thrifts and consumer banks in California for his next fixer-upper. "You can expect another deal within 12 months," says Killinger. His goal? "To become the West's premier financial-services company."

Given the speed at which he moves, few are betting against him. He is known to blow through an entire day of meetings without food on two hours of sleep. On his only free weekend during the three-month fight



POWER SHOPPER
Exec Killinger is scouring California for fixer-uppers

Killinger's growth plan has been to transform Washington Mutual from a traditional thrift into a consumer bank that functions as a category-killer in mortgages, checking accounts, and home equity loans. Washington Mutual's return on common equity is 19.4%, compared with 7.9% for the median thrift and 13.5% for the median commercial bank. It is the No. 1 mortgage lender in the Pacific Northwest, second only to Bank of America in California.

against Ahmanson this spring, he tore down the wallpaper and pulled up the carpets in a bedroom at his home, slapped up new paper, and went off to the store for a new set of furniture.

Despite his wealth, he eschews CEO trappings. He insists on cutting his own lawn with a push mower. With bulky gold eyeglass frames and plain gray suits, he doesn't exactly stand out in a crowd. Killinger is far more conspicuous on Wall Street, where his stock performance has won him a cult following. That proved crucial in his victory over Ahmanson. From March to June, as Killinger sped across the country showing volumes of charts and graphs to investors, his stock, after a dip, shot up 20%, wiping out the price differential between Ahmanson's and Washington Mutual's bids.

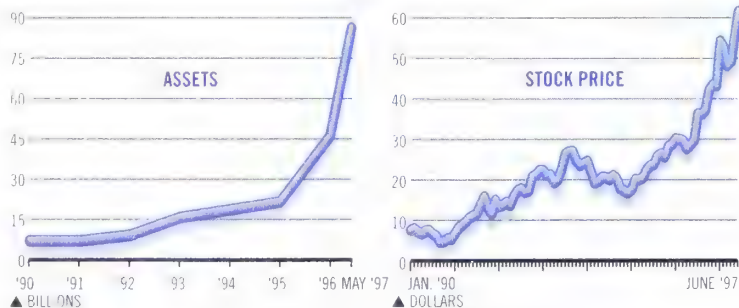
Despite 20 acquisitions in the past years, Washington Mutual is the most efficient large thrift. Its proprietary technology enabled it to cut loan closure time from 45 to five days. That has lifted the number of mortgages WAMU closes to 72% of the applications it processes versus Great Western's 49%. With fallout so minimized, it costs WAMU just \$1,400 to originate a loan, vs. \$3,300 at Great Western. "WAMU is one of the only institutions that has made the mortgage business work," says R. Jay Tejera, an analyst at Dain Bosworth Inc.

Killinger, though, is aware that at his stock and stature at stratospheric levels, he has no room for error. What did catch him off-guard was the June 13 meeting of Washington Mutual's shareholders to approve the Great Western deal. The usually levelheaded

Midwesterner broke down in tears as he thanked his executive team and his wife. He has been by his side since they were in high school and second first time in the high school band. Then, recovering from the shock, he exclaimed: "We're going to get some time to get some sure." Maybe a minute tops.

By Kathleen M. Moriarty
with Seanna Browne
in Seattle

BUILDING WASHINGTON MUTUAL—FAST

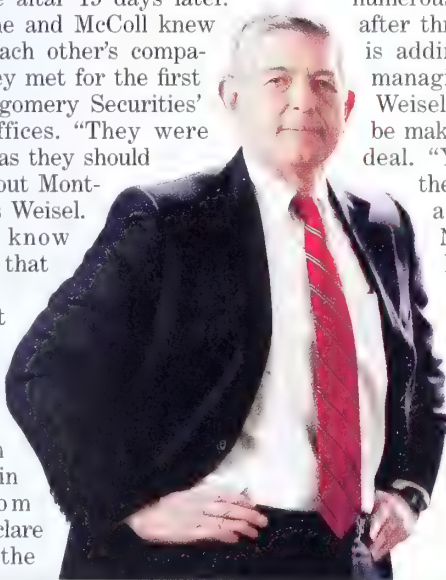


DATA: WASHINGTON MUTUAL INC. ■ BLOOMBERG FINANCIAL MARKETS

LOVE AMONG THE HEAVYWEIGHTS

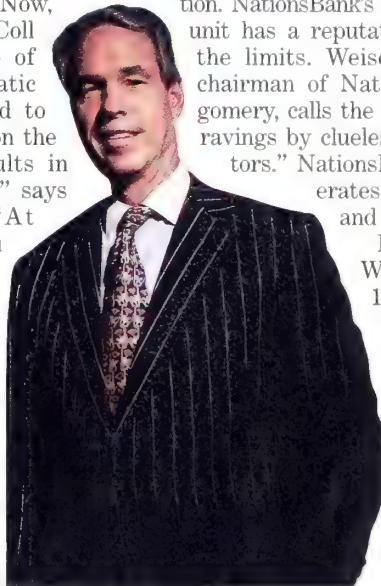
Is splurging on Montgomery pay off for NationsBank?

As if NationsBank Chief Executive Hugh L. McColl Jr. went on a blind date with Montgomery Securities' Executive Thomas W. Weisel on the 10, became deeply infatuated and ended to the altar 19 days later. Weisel says he and McColl knew a lot about each other's company when they met for the first time at Montgomery Securities' New York offices. "They were as aware as they should have been about Montgomery," says Weisel. "I didn't know NationsBank that well, either." That didn't stop McColl, who heads the fourth-largest U.S. bank, with \$9 billion in assets, from agreeing to declare his vows to the



he is striving to make NationsBank a big player in investment banking. But so far, his grand vision has proven easier to enunciate than execute because of lax oversight, overaggressiveness, and numerous miscalculations. Now, after three big flops, McColl is adding the challenge of managing the autocratic Weisel, who is rumored to be making \$100 million on the deal. "You have two cults in these organizations," says a competitor. "At NationsBank, you have a Hugh McColl cult; at Montgomery, it's a Tommy Weisel culture."

SAYS WEISEL (RIGHT): "WE STIPULATED THE PRICE. MCCOLL SAID 'DONE'."



tionsBank's hometown of Charlotte, N.C., many quickly clashed with the bank's brass and were fired or left. NationsBank says it lost only 26 bankers, but a former executive says it was more than 100. In fact, buying Montgomery is really NationsBank's way of crying uncle. "They realized they totally messed up and can't integrate a firm into the bank," says the former exec. "They'll buy a big firm and get out of the way."

LEAKS? One reason the companies could find it hard to meld is that each has an every-man-for-himself culture. Indeed, Montgomery has faced charges from competitors that it leaks research reports to favored clients ahead of public distribution. NationsBank's corporate-finance unit has a reputation for pushing the limits. Weisel, who will be chairman of NationsBank Montgomery, calls the charges "jealous ravings by clueless local competitors." NationsBank says it operates within the law and business ethics.

McColl and Weisel believe 1+1 will be 3. Since both focus on middle-market, high-growth clientele, NationsBank's strong commercial-banking abilities should dovetail

WHAT THE MATCH HAS GOING FOR IT—AND WHAT COULD GO WRONG

PROS

- NationsBank gets instant credibility in securities underwriting, especially in health care and technology
- Deal gives bank a foothold in the key California market and may portend a bank purchase there
- NationsBank's commercial-banking abilities dovetail with Montgomery's equity-financing strength

San Francisco-based regional securities firm. "There was no negotiation over the price," says Weisel. "We stipulated the price. McColl said 'done.'" Other suitors—ING Barings, BankBoston, and Société Générale, say Street sources—fell by the wayside, scared off by the price. **DOLLAR.** And what a price it was: \$10.6 billion, plus \$100 million in pay for partners—a breathtaking 10.6 times Montgomery Securities' current book value of \$113 million. Of that, \$840 million is cash, with the remaining \$360 million paid out in NationsBank stock over the years. Says one money manager: "They are buying right at the top." McColl was willing to pay up because

Both have a 'do it my way' strategy." In 1993, NationsBank paid a princely \$225 million to acquire Chicago derivatives firm CRT Group Ltd. It had no experience in trading for customers and has never met NationsBank's performance goals. In 1994, McColl had to close down a securities-brokerage partnership with Dean Witter Reynolds Inc. after a spate of regulatory actions and customer complaints alleging improper sales practices, which were settled or dismissed. And the firm is still struggling with a major staff buildup in investment banking launched in 1993 with great fanfare. After persuading dozens of high-profile Wall Street bankers to move to Na-

CONS

- NationsBank's McColl and Montgomery's Weisel have sizable egos, which could cause sparks
- Paying a pricey 10.6 times book value could reduce NationsBank's return on investment
- With just 68 Montgomery partners dividing \$1.2 billion, it will be tough to motivate them

with Montgomery's strengths in equity financing. Still, though Montgomery ranks 13th in equity underwriting so far this year, in 1995 and 1996, it ranked dead last among the top 25 securities underwriters in the stock market performance of companies it brought public, according to Securities Data Co.

Banking analysts now see McColl moving on to other prey, maybe a California bank, to become national. In the meantime, his new employees at Montgomery will be very busy...counting their money.

By David Greising in Atlanta, with Kathleen Morris in Los Angeles and Leah Nathans Spiro in New York

STOCKBROKERS

'FLAT FEE' ACCOUNTS: READ THE FINE PRINT

Brokers' no-commission offerings may have hidden charges

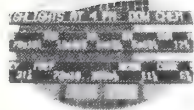
It has been a problem since the dawn of the retail brokerage business: Brokers have a strong incentive to get customers to trade when it might be in clients' interest to do nothing. Responding to criticism of this conflict of interest, many firms such as Merrill Lynch, Smith Barney, and PaineWebber have recently promoted "relationship" or "fee-only" accounts. Instead of

industry gadfly Leslie Silverstone: "The ads do not disclose that there is an extra incentive for a Merrill Lynch broker to sell a customer a Merrill underwriting, when there is."

Merrill Lynch & Co. initially defended its advertisements. But in response to queries from BUSINESS WEEK, James G. Bennett, the program manager for the account, said it would change its ads.

The Merrill Lynch Planning Difference

Merrill Lynch offers an alternative to commissions.
Introducing a unique way to manage
all your finances for one annual fee.



No Commissions on Transactions

For a wide variety of
investments including Stocks
Bonds and Mutual Funds.

charging per-trade brokerage commissions, customers pay flat annual fees for a set number of trades. That, say the firms, puts the broker on the same side of the table as the customer.

Well, not always. Although firms don't go to a lot of trouble to point it out, customers in fee accounts are charged extra fees for purchasing initial public offerings—putting the broker right back on the other side of the table.

DISAGREES. The leading example is the Merrill Lynch Financial Advantage (MLFA) service. The headline of its ad campaign says: "Merrill Lynch offers an alternative to commissions." The ad continues: "No commissions on transactions. For a wide variety of investments including stocks, bonds, and mutual funds." But read the fine print of the agreement that customers sign to register for the MLFA service. In addition to the flat fee of 1.5% to .75%, brokers will be paid a "selling concession," or commission on "new issues of equities and fixed-income securities." Says former Dean Witter branch manager and

"Any future ads or materials will explicitly tell clients that new issues are not eligible for the service," he says.

Regarding charges for IPO purchases, Bennett says that these trades do not reduce the client's number of allotted trades. And in practice, he says, "less than 3% of transactions in the financial advantage account have been new issues," he says.

But Smith Barney Inc.'s AssetOne account charges the customer only once for trading IPOs. Smith Barney pays its brokers a commission for selling new issues. But it excludes the IPO amount from the flat fee. So if a Smith Barney customer had \$200,000 in a fee account and bought a \$20,000 IPO, the flat 1.5% fee would be charged only on \$180,000. Under the Merrill system,

the fee would be imposed on the entire \$200,000. "We do it differently than Merrill," says Smith Barney Executive Vice-President Jay Mandelbaum. In IPOs, customers do not get billed an AssetOne fee on top of the selling commission." Smith Barney also doesn't reduce the client's allotted number of trades for buying an IPO.

MANY VIRTUES. Smith Barney handles two other issues differently. What happens when a client makes 13 trades when his allotment is 12? "We charge a discounted commission but the financial consultant is not paid. There is no incentive for the broker to do extra trades," says Mandelbaum. Not so Merrill. Says Bennett: "The customer pays the regular commission." And a Smith Barney client has more than 50% of his assets in cash, the flat fee is charged on the cash over 10%. At Merrill, the MLFA fee applies to all eligible assets within the account. Bennett says if a customer has that amount of cash, it is usually temporary.

PaineWebber Inc.'s

B. New Issues: The MLFA Fees will be applied to new issues of equities and fixed-income securities purchased in the MLFA Group. The Client should understand that new issues can only be purchased at the public offering price and that Merrill Lynch will not receive a selling concession, or other compensation, as described generally in the related prospectus, offering circular or official statement, in addition to the MLFA Fees payable hereunder. A purchase in the MLFA Group of a security subject to a public offering may not, however, be counted against the MLFA trade allotment. The Client may determine to purchase new issues in any MLFA Account in certain limited circumstances, but such purchases should be carefully considered where the Client intends primarily to purchase new issues.

PUZZLING

Merrill's ad touts
no commissions
on stocks, while its
customer agree-
ment says brokers
are paid commis-
sions on IPOs

Premier Account and Prudent Valued Investor Program handle IPOs the same way Merrill does, according to spokesmen for the firms. As for Dean Witter's Choice account, spokesman Tim Lee didn't respond to BUSINESS WEEK's faxed questioning comment.

It's true that fee-only accounts have many virtues. They give customers access

to a wide variety of brokerage services while reducing the role of commissions. "It's a positive move for both the consumer and the industry," says Louis Harvey, president of Dalbar Inc., a financial-service research firm. Still, the offerings are all less than a year old with Merrill Lynch the only one so far to advertise. Maybe more time and more competition will give fee-only investors a fairer break.

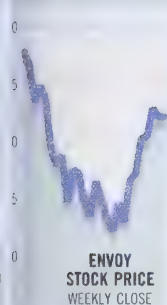
By Leah Nathans Spiro in New York

Y GENE G. MARCIAL

ENVOY'S FORMS ARE IN ORDER

Shares of Envoy (ENVY) were trading at 32 on July 1, up from 22 two months earlier, a 45% jump. In part, the stock was rebounding from a bad fall—along with other health and technology issues. The rally was helped along by Envoy's mid-June takeover

MEDICAL RIVALS SEEM INTERESTED



DATA: BLOOMBERG FINANCIAL MARKETS

of Healthcare Data Interchange from Aetna U.S. Healthcare. But there's another reason pros are buying: a possible buyout.

"Acquisition of the Aetna unit makes Envoy the leading pure play in the fast-growing electronic processing of health-care claims," says analyst Joel Krasner of First Albany, a New York investment firm. Larger companies in the business, he says, will find Envoy an attractive target. His price goal for the stock this year is 40. In a buyout, it's worth 50 to 75, figures Krasner.

Envoy processes pharmacy insurance forms and third-party reimbursement claims for doctors and other health-care providers. It also provides eligibility verification and other services. To do that, Envoy uses proprietary software and microprocessor technology in dealing with 188,000 doctors, 44,000 pharmacies, 30,000 dentists, and 3,700 hospitals.

A New York money manager who has been buying shares in hopes of a takeover believes that HBO & Co., which applies computer systems to health-care outfits, is sounding out Envoy. HBO, with a market capitalization of \$6.7 billion, has been busy acquiring smaller companies in the same business. With Envoy's market cap at \$519 million, "it's an easy bite for HBO, whose sales this year are expected to exceed \$1 billion," says this pro. Envoy is expected to produce revenues of \$100 million this year.

With its recent acquisition, Envoy will become the clearinghouse for most of Aetna's claims. "The acquisition will

increase earnings, and we may raise our estimate for 1998," says Krasner.

He notes that, with 23.5 million patients enrolled with Aetna U.S. Healthcare, each one filing one claim a year on average, "the potential revenue opportunity is substantial." He figures Envoy will make 78¢ a share this year and \$1 in 1998 (exclusive of nonrecurring items and goodwill associated with acquisitions), up from last year's 45¢.

Envoy CEO Fred Goad couldn't be reached. CEO Charles McCall of HBO says: "Envoy operates in an area we're very interested in," although he did not say that HBO was looking at Envoy.

FRESH RUMBLINGS AT GRYPHON

Earthquakes are bad news, especially for insurers who sell policies against them. Yet the stock of Gryphon Holdings (GRYP), a property-and-casualty insurer specializing in quakes, hasn't cratered. In fact, it's on the rise—despite a pretax loss of \$11.5 million resulting from a California earthquake.

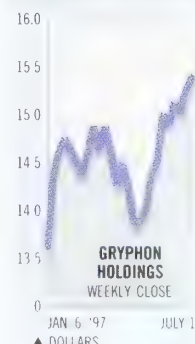
"No doubt about it: Management is concerned about pressure from the Street to get earnings up," says investment manager Jim Awad. Unless it turns the numbers around, he adds, Gryphon will be "easy prey for raiders."

With the stock at 15—equal to its book value—and the company underperforming, "it's a matter of time before somebody comes in and buys Gryphon. It's worth 50% to 75% more than the current price," says Awad.

A number of investors smell a bargain in Gryphon, causing the stock's runup—from 10 a share to 15 since late April—notes Awad, who heads Awad & Associates Asset Management, a unit of Raymond James Financial. "Gryphon's peers trade at more than 1.5 times book value," says Awad.

Gryphon President Stephen Crane acknowledges that unless the company "produces value to shareholders, we'll be vulnerable" to a buyout raid. But he's confident that "we'll produce high-

"EASY PREY FOR RAIDERS"



DATA: BLOOMBERG FINANCIAL MARKETS

er results this year." Crane says the disappointments of 1996 are behind the company: It is positioned for improved profitability in 1997. About 24.5% of Gryphon's gross premiums comes from commercial earthquake-insurance policies in California.

Walter Fitzgerald of investment bank Brean Murray sees Gryphon producing 1997 revenues of \$120 million, vs. \$106 million in 1996, and earnings of \$1.80 a share, up from 88¢.

MAKING HAY FROM INSIDER SELLING?

Consolidation is still the buzzword in health care, as the biggies spread their wings through mergers. An outfit some hedge funds are buying is Regency Health Services (RHS), whose shares have rocketed from 9 to 15.

A surge of buying took place quite recently—about the time early investors with big blocks of shares were selling. So why was the price climbing despite all that unloading?

To some pros, it had become evident that a large health-care service company had mounted a sophisticated program of accumulation—to take advantage of insider groups' selling.

"Regency is worth 22 to 25 in a buyout," figures one New York investment strategist who has been tracking the stock. "It's a sight to behold when heavy selling by big-block holders translates into rising prices," he notes. The pattern signals that the persistent buying is on behalf of a group with buyout designs. CEO Richard Matros says speculation that Regency is a takeover target is totally unfounded.

Regency, which provides inpatient services at 166 facilities in six states, including California, North Carolina, and Ohio, had revenues of \$558 million last year and earnings of 32¢ a share, vs. 1995's \$416 million and 17¢. Analysts expect Regency to earn 91¢ this year and \$1.04 next. The company's services include rehabilitation, skilled nursing, neurological care, and assisted living.

A SURGE OF HEAVY BUYING



DATA: BLOOMBERG FINANCIAL MARKETS

Corporate Crown Jewels

Building Business Around Information

PRESENTED IN
ASSOCIATION WITH

EMC Corporation

SPONSORED BY

Informix Software, Inc.

SAP America, Inc.

"Those first to apply new transportation technologies always win world leadership. The transportation technology of the early 21st century is telecommunication. And so it is the corporate chief information officer who now holds the central role."

Bert Roberts, chairman, MCI Communications Corporation

Information As The Corporate Crown Jewels

Drawing modern parallels to 15th century Portugal and 19th century England, MCI chairman **Bert Roberts** opened a new *Business Week* event, CORPORATE CROWN JEWELS. The meeting brought together the elite of corporate information technology: the chief information officers who are turning company data into 'corporate crown jewels' of competitive advantage.

Bert Roberts shared the story of *Friends & Family*, "born around a table where three or four people of different disciplines were asking how we could make better use of the data hiding in our information systems. The key was data mining, a back-office technology." (See "We're Getting To Know You.")

Back Office To The Fore

Today's back office is the powerful enabler of corporate competitiveness. Database systems integrated with first-class storage technology yield new products and services — *Friends & Family* is a prominent example.

"Information technology has moved from support function to strategic function," says **Albert Aiello, Jr.**, of mutual funds giant Fidelity Investments. "Our systems have become the business." This is particularly the case for Aiello, Fidelity's former chief information officer, now president of OPServer and Intelligent Document Factory, two businesses created out of technologies initially developed to serve Fidelity's internal needs. Eleven percent of the participants at this *Business Week* event report that their

IMAGINE BEING THE CIO OF NETSCAPE



Larry Geisel

senior vice-president,
information systems, and
CIO, Netscape

In just two years, Netscape Communications Corporation set in motion a software revolution that touched the entire computer industry. Netscape's *Navigator* is the long-awaited 'next killer-app.' The software application

that is driving a new wave of interest and investment in computer technology. With more than 50 million copies online, *Navigator* is already the most-used piece of software in the world.

Netscape's senior vice-president, information systems, **Larry Geisel** captivated an audience of his CIO peers at *Business Week*'s CORPORATE CROWN JEWELS gathering:

He's Got The World's #1 Website

"Seventy-five percent of all internet users use our Web site as their gateway. I can't predict how much capacity we will need, so I just keep adding people, buildings, facilities, locations. We operate on a 'field of dreams.' It's an act of faith that 'if we build it, the customers will come.' And they have.

"One hundred and thirty-five million hits a day is a challenge in itself. Netscape has invented high-volume transaction processing over the Internet. I download over 100,000 new products to customers every day. Last year, we downloaded a million servers, building our market for the future."

CROWN JEWELS / EUROPE, the next event in the *Business Week* CORPORATE CROWN JEWELS series for Chief Information Officers of large corporations will be held October 27 and 28, 1997 at Hôtel Le Grand Intercontinental, Paris. For more information, contact Julie Terranova in New York at (212) 512-2184 or Jennie Vint in London at (44-171) 491-8985.

by Scott Shuster,
moderator of The
1997 *Business Week*
Corporate Crown
Jewels conference

BusinessWeek

Beyond news. Intelligence.

ENTERPRISE STORAGE ARRIVES



**Data storage
choices impact
competitiveness."**

Michael C. Ruettgers
president and chief
executive officer,
EMC Corporation

er and chairman of the board of Informix Software, Inc. The data is
licated and cut into 'data marts,' smaller pieces that are sent to accounting
sales organizations where it is mined for new knowledge (see "We're
tting To Know You").

Database software is also gaining new importance and differentiation.
ur business was built on transaction processing," recalls White. "Now
are focused on end-user productivity, making database applications
ier to use." The latest release of Informix database software is "ready
much more than numbers, characters, bar charts, and pie charts,"
s White. As multimedia applications arrive, it will become "easier to
ke use of rich content and digitized images. Productivity should grow
matically through the use of new forms of data. Spacial data, for
mple, will permit you to look at a customer's address latitudinally
d longitudinally. This will enable new types of sales development and
ny other management innovations."

departments have also made the transition
cost-center to profit-center (see "The
lenging World of a Corporate Chief Infor-
on Officer").

We Are Strategic

e my role as universal partner," says Denis
eary, chief information officer of The Chase
hattan Corporation. "I help craft every-
s plans. Our businesses do not write their
egies, hand them over and say 'enable me.'
ticipate in their planning and I'm a partner
e execution." O'Leary's role is not an option
Chase business unit managers. Chase's
D and President "have made it clear that
expect me to contribute on all elements of
strategic planning and operating reviews.

"Storage is central," says **Denis J. O'Leary**, chief information officer of
The Chase Manhattan Corporation. "It must be first-tier and fast. Otherwise
we cannot operate." O'Leary described **Mike Ruettgers**, CEO of storage
systems leader EMC Corporation, as "one of my key partners."

So has enterprise storage become a strategic technology? "Yes," says
Ruettgers, "because storage is emerging as the best way for corporations to
get their arms around all of their critical data and make it rapidly available.
Enterprise storage is literally central because it can accommodate all computers
simultaneously. The software intelligence of today's storage systems means
better performance for large databases and data warehousing and is making
true information sharing possible across the enterprise."

Once properly stored, company data can now be 'mined' for valuable
new awareness. "Data warehouses are doubling
the usefulness of company information," says

Phillip E. White, president, chief executive



**"Productivity
should grow
dramatically
through the use of
new forms of data."**

Phillip E. White
president, chief executive
officer and chairman of
the board, Informix
Software, Inc.

I have the good fortune to be in an organization
headed by people who understand the impor-
tance of technology," says O'Leary.

This central, strategic role means a CIO
must be more than a technologist. Only 6% of
the CIOs at Business Week's CORPORATE
CROWN JEWELS gathering had a strictly tech-
nological background. Forty-three percent had
technological/operational education with an
MBA or similar studies, and another 43% had
no technology education at all.

Organic, Holistic, Dynamic Change

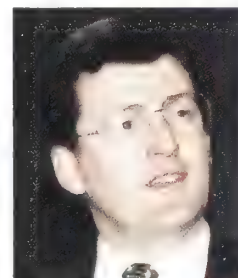
In many instances, the CIO is also the individual
responsible for leading change in the company.
So add "consummate team player/team leader"
to the list of prerequisites. "We are not adding

Corporate Crown Jewels



**"Our systems
have become the
business."**

Albert Aiello, Jr.
president,
OPServer/Intelligent
Document Factory,
and former CIO,
Fidelity Investments



**"Our businesses
do not write
their strategies,
hand them over
and say 'enable
me.' I participate
in their planning
and I'm a partner
in the execution
of their plan."**

Denis J. O'Leary
executive vice-president
and CIO, The Chase
Manhattan Corporation

Corporate Crown Jewels



"One dollar spent on company-wide integrative systems gets you five dollars back. That's not a bad return."

Paul Wahl
chief executive officer,
SAP America



"Power will migrate out from your intranet onto your extranet, and beyond the boundary of your company."

Stan Davis
professor and author,
Future Perfect, 2020
Vision, and *The Monster Under the Bed*

information technology to an old business model," says Chase's O'Leary. "We are not strapping on more MIPS and bytes and budget dollars to push a bigger hammer. We are fundamentally redesigning every business because information technology will put us ahead of our competitors. This is comprehensive, holistic change, redesigning the business from scratch with a dynamic organic model that yields powerful new ways of doing business."

"The business process is more important than any individual business function," states **Paul Wahl**, CEO of SAP America, and one of the developers of its immensely successful R/3 integrated software products. "Process over function is the idea SAP brought to the market. It has flown so high simply because R/3 enables companies to do things they were not able to do before."

Spend One Dollar, Get Five Dollars

"Building this model is expensive," says Denis O'Leary. "We have to re-architect how we use the legacy platforms where we have the big mainframes, the high input-output, and the proven COBOL code with robust toolsets. That's still an excellent way to handle the basic through-put. But all that must now be wrapped with middleware — like security — and then put on distributed tools for ease of use and flexibility."

"The front-end connectivity (Web pages, for example) is your route to the new competitive marketplace. But a 1-800 number and a Web site do not make you globally-enabled in IT. That depends on your platforms of information navigation and transaction enablement. Most people are not prepared for the high cost and heavy COBOL development required to re-write all those platforms."

"A lot of my customers talk about the cost of making these changes," says SAP's Wahl, "but they also talk about value. One dollar spent on company-wide integrative systems gets you five dollars back. That's not a bad return. Nobody talks about it because they don't want their competitors to know. They have changed their core business with these systems. They have achieved high margins. They don't want that information widely disseminated, so they talk about how expensive it was up-front. The true story is one of a very high return on investment."

How Change is Changing

What is the next challenge facing the chief information officer? According to **Stan Davis**,

longtime member of the Harvard and Columbia Business School faculties and author of *Future Perfect*, today's CIO should be planning to cope with a dramatic shift in the locus of organizational power: The corporate intranet is already disseminating power from the center (the CIO) toward the company periphery, individual

THE CHALLENGING WORLD OF A CHIEF INFORMATION OFFICER

The job of CIO has always been a tough one. Today the CIO has a new high profile in the firm, a growing strategic role, and a soaring budget. Everything depends on the quality of the information system, and if you're the CIO that means everything depends on you. This anonymous poll of corporate chief information officers was conducted at Business Week's *Corporate Crown Jewels* gathering. Wireless in-hall polling system provided to Business Week by **Meridia Interactive Information Services**, Plymouth Meeting, PA.

Am I worried about my department's ability to manage information across the entire enterprise?

I'm worried: 92%
I'm not worried: 8%

Am I worried that my information management techniques may jeopardize the performance of my company?

I'm worried: 84%
I'm not worried: 16%

Resistance to new uses of information technology at my company:

A thing of the past: 26%
Only in a few old-timers: 30%
Still a significant problem: 43%

I am spending more money than ever before on information technology:

Yes: 69%
No: 31%

The CIO's role is of strategic importance:

Yes: 92%
No: 8%

My CEO thinks the CIO's role is of strategic importance:

Yes: 78%
No: 22%

As CIO, my interface with business unit managers is:

Excellent: 18%
OK but could be better: 60%
A constant struggle: 20%
Little contact: 2%

employees, and consultants. Next, says Davis, power will migrate out from your intranet onto your extranet, and beyond the boundary of your company. Nearly all of today's organizational change is internally focused. Within a decade

three-quarters will be inter-organizational."

This will be an entirely new discipline of change, driven — like so much else on today's corporate landscape — by the advance of information technology.

WE'RE GETTING TO KNOW YOU



The key to Friends & Family as our back-office technology."

Bert C. Roberts, Jr.
chairman,
MCI Communications Corporation

The Calling Circle That Changed The World

"Friends & Family was more than a new product. It was a new approach to the market, a redefinition of telemarketing, customer service, credit management, account management and billing. It is a story of technology and also of fundamental organizational and operational change that released the technology's power.

— Bert C. Roberts, Jr., chairman, MCI Communications Corporation

80-million Customers, One-At-a-Time

"You need one view of the customer. In the old product-house landscape, AT&T had eight views in isolated databases across the company. We integrated. We segmented, and we customized down to a market size of one."

— Ron J. Ponder, executive vice-president, AT&T

"We analyzed 250 billion call records. We noticed many short calls from universities to homes, followed by calls back to the university. That stimulated the launch of *True Ties 800*, the personal 1-800 service for families, a very successful service."

— Alan G. Jones, vice-president/general manager and CIO for consumer markets, AT&T



"Customize down to a market size of one."

Ron J. Ponder
executive vice-president,
AT&T

Replacing Cash

"In Singapore you can accumulate loyalty points on your Smart Card and receive discounts or free merchandise. The Smart Card system opens a world of new marketing techniques."

— Jerry McElhatton, president, global technology and operations, MasterCard International

Information Technology That Saves Lives

"Many people see five or six different doctors who may be unaware of all the prescriptions that patient is taking. The (Eli Lilly) PCS database will alert the doctor and pharmacist if the combination of drugs is dangerous. We have 65-million people in the PCS database."

— Thomas Trainer, vice-president, information technology and CIO, Eli Lilly and Company



Database research stimulated the launch of a very popular, very successful service."

Alan G. Jones
vice-president/general manager and CIO for consumer markets, AT&T

Corporate Crown Jewels



"We're still at the beginning of information technology. The opportunities facing us are much greater than our achievements to date."

Max Hopper
principal, Max D. Hopper Associates, Inc., formerly senior vice-president, AMR Corporation (American Airlines), and chairman, The Sabre Group



"The Smart Card system opens a world of new marketing techniques."

Jerry McElhatton
president, global operations and technology, MasterCard International

BusinessWeek

Beyond news. Intelligence.

PAIN IN PLEASANTVILLE

Reader's Digest's scary story: Lower profits, fewer readers

Reader's Digest Association Inc.'s legendary founder, DeWitt Wallace, condemned big profits. Rather than adding to his company's coffers, he preferred showering workers with Thanksgiving turkeys, shortened summer days, and surprise raises. Millions of dollars went to charities. "The dead carry to their graves," he once said, "only that which they've given away." Today, Wallace's antiprofit doctrine is being resurrected at Reader's Digest—but it isn't quite what he had in mind.

Operating earnings at the once-flush publisher have fallen for four straight years, from \$393.7 million in fiscal 1994 to an expected \$251.7 million before restructuring charges in fiscal 1997 on \$2.9 billion in estimated sales. The staff has been cut by 20%, to 6,000. The company's market value has been halved during a bull market. The slide is slashing the budgets of the two nonprofit funds that control most of Reader's Digest's voting stock. Even CEO James P. Schadt, 58, may lose his \$600,000 bonus, along with his taste for interviews. He refused repeated requests for comment. "It's a disaster," says Marion Kessler, a portfolio manager at Crabbe-Huson Group Inc., an institutional owner of 1.5 million shares. "Reader's Digest is one of the greatest franchises in the world and it's being run into the ground."

"MORIBUND." Seventy-five years after Wallace and his wife, Lila, started Reader's Digest with \$600 in cash, the king of condensed books is struggling to mail out its feel-good messages profitably. Its flagship magazine is still the most popular publication on the planet, but aging readers and intense competition mean Reader's Digest must add 5 million new readers annually just to maintain its circulation of 27.5 million. It's "a case of diminished geriatric returns,"

says Ivan Obolensky of Shields & Co. "This is a moribund company."

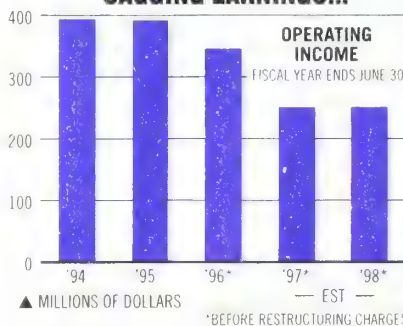
For most of its history, Reader's Digest was a prosperous private company. So investors eagerly snapped up an offering of nonvoting shares in 1990, as former CEO George V. Grune built on the world-famous brand, targeting magazine readers with offers for specialty magazines, books, audiocassettes, and videos, using sweepstakes as a lure. Although the magazine only accounted for about 25% of the company's revenues, it was used as a "front door" to the books-and-entertainment unit, which pulled in the bulk of sales and profits.

At first, it worked. From 1990 to 1993, operating earnings shot from \$240 million to \$352.7 million, while revenues went from \$2 billion to \$2.9 billion. But customers soon complained of being bombarded with junk mail and grew tired of not winning the sweepstakes. In 1994, sales fell to \$2.8 billion. In early 1994, Grune and then-Chief Operating Officer Schadt—who would take the top job in August—announced a fix-it plan. To win back disgruntled customers, they cut mailings, sweepstakes, and prices, and they beefed up customer service. They also slashed jobs.



SCHADT: Shareholders are wary of the CEO's turnaround plan

READER'S DIGEST'S SAGGING EARNINGS...



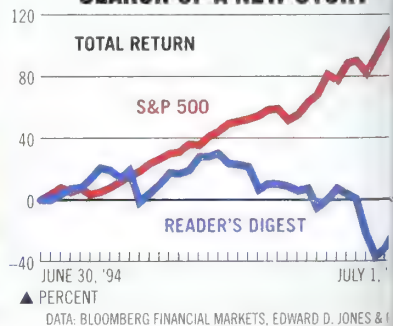
But they still needed new readers. The duo took a longer-term view. Their plan included pushing into one untapped market a year, buying magazines that appealed to a younger crowd, and signing joint ventures with the likes of Avon, Microsoft, and Meredith, publisher of *Loose Women*. Avon would sell magazines with makeup, Meredith would target younger readers, and Microsoft would create CD-ROMs on everything from home improvement to gardening.

So far, the new strategies have had little effect. In two years, almost every unit—from magazines in Asia to music in Europe—has seen sales fall. What went wrong? In public statements, the company blamed outside forces—rising newsprint prices, for example, and weak economies in Europe, where it derives 45% of its revenues. Analysts and investors say Reader's Digest didn't adapt to a changing world, hasn't exploited its vast database—one of the world's largest with information on 100 million people—and that its premise of selling books by mail is outdated. Complicating matters was a wave of more than two dozen senior-level departures coinciding with Schadt's rise to power. "It became impossible to execute the plan without these people," says a former executive.

MORALE CRISIS. The most devastating loss, say investors and ex-employees, was that of Ken Gordon, who had led the company's European operations and was considered a CEO candidate. Although he was named COO in 1995, he was named to the company's board, he suddenly retired in June, 1996, at age 58. People who worked with Gordon and Schadt say they were bitterly divided over how to carry out the strategy. Gordon says simply: "The company is going through a major change, and it's no more difficult than anybody anticipated."

Morale went through the floor. Not only were top executives leaving, but the company was also losing some of its best midlevel workers to a voracious

HAVE INVESTORS IN SEARCH OF A NEW STORY





early-retirement plan. The company's remaining began to dwindle, and it was losing money, like the bus ride to its headquarters in the posh Westchester community of Chappaqua, N.Y. The company uses the neighboring town of Pleasantville for its official address. "It was such a generous place to live," says Kessler. "Now it's like the end of the world."

Although investors have been hit hard by the troubles, their lack of votes means it's hard to press for change. After Wallace's death, he left 90% of the company's voting rights to his charities, the DeWitt Wallace Reader's Digest Fund and the Lila Wallace-Reader's Digest Fund. Most of the rest was held by an employee stock ownership plan and former executives.

It's a tight-knit group. Many of the company's board members also sit on the boards of the funds, including the funds' president M. Christine DeVita, Reader's Digest's general counsel Melvin R. Laird, Chase Manhattan Bank CEO Walter W. Wriston Jr., and former CEO Walter E. Wriston. Ex-CEO Grune has chaired the funds' board since 1984. "This is the closest relationship between a corporation and its investors I've ever seen," says a Monks of LENS, an activist investor.

"It will make it impossible for the company to turn around." The company has severed these relationships have been fully severed. Board members wouldn't com-

ment on the structures.

The setup has kept Monks and other shareholder activists at bay. "I examined investing, but came to the conclusion that there's nothing we can do," he says. Michael Price, chief executive of Franklin Mutual Fund Advisors, agrees. He was the prime suspect when the volume of Reader's Digest shares skyrocketed in May, but he says he was golfing that day and has no interest. "It's being run poorly," he says, "and there's nothing anybody but the funds and the board can do."

HOT LIST. Some on Wall Street think the company's slide is beginning to erode the solidarity between the board and the funds. The falling stock has reduced the assets of the funds from \$1.2 billion in 1995 to \$906 million last year, forcing them to reduce their giving and to search for new money. "My sense is there's a lot of heat building behind the scenes," says analyst Doug Arthur of Morgan Stanley Dean Witter Co. With only \$150 million in cash left, down from \$800 million three years ago, investors say the juicy \$180 million annual dividend—of which the fund gets 22%—is in jeopardy and could be cut in a mid-July

meeting. But that could tank the stock. Says Obolensky: "The only thing that props up the stock is the dividend."

Schadt is asking for patience once again. In April, he announced that he would invest up to \$400 million in non-mail marketing such as catalogs, television, the Internet, and door-to-door sales, and lower prices further. Reader's Digest will expand further overseas and buy more magazines. The result, he vows, will be high-single-digit sales growth and operating profit growth of about 10%—eventually. "We're managing for long-term growth, not short-term profits," says director William J. White, chairman of Bell & Howell Co.

Shareholders are skeptical. The stock plunged 11% after the announcement, and Kessler of Crabbe Huson called a top Reader's Digest exec. "I said, 'What makes you think you're not throwing good money after bad?'" The stock now trades at about 28%, down 29% from last January's high of 40%. But not everybody has lost faith. There are the mystery investors, not to mention some executives who are buying stock. If all else fails, there's always the multimillion-dollar art collection and the vaunted database, which, says analyst Peter Appert of Alex. Brown & Sons, "would be priceless to everyone from Rupert Murdoch to Bill Gates." Along with vanishing profits, these, ironically, are about the only remnants the Wallaces left behind.

By I. Jeanne Dugan in New York

COMPUTERS

CAN THIS MAN REV UP DIGITAL?

Marketing whiz Bruce Claflin has to fire up sales—fast

Bruce L. Claflin has spent the past 18 months battling to turn around Digital Equipment Corp.'s personal-computer business. He did. Then his boss, CEO Robert B. Palmer, went and sued Intel Corp., charging that the chipmaker had stolen pieces of Digital's patented Alpha chip technology. Claflin's problem? Intel supplies the chips inside 85% of the world's PCs, including \$2 billion worth sold by Digital.

Now what? Claflin is charging full steam ahead, hassles or no with Intel. In the days following Digital's suit, he began calling big customers to explain the company's position and calm any jitters. "But I found it alarmed them more than reassured them," he says. Now he's explaining only when asked and making it clear that Digital will continue to hawk Intel products—even though the chip giant has hinted that it might cut off supplies. "Intel's strategy is to try and cause us harm in the marketplace," Claflin says. "So we need to step up our efforts."

And fast. Palmer thinks that Claflin—a 22-year veteran of IBM and the marketer behind the wildly popular IBM ThinkPad laptop PC—is up to that challenge and more. On July 1, Claflin, 46, became the executive with responsibility for the largest chunk of Digital's revenues, taking over as senior vice-president of a new marketing and sales organization that must now do more with less. Over the past three years, the sales group has been slashed nearly in half, to 5,600 people, while the pressure has mounted

to boost Digital's revenue growth beyond its anemic 4.5% rate. Palmer is banking that Claflin's knack in PCs—he turned in profits despite a 7% dip in sales—can work elsewhere at Digital. "Bruce delivered a profit and exceeded all his goals," says Palmer. "That's an example of better execution."



And that's what Digital badly needs. Claflin's first mission is to ignite sales of both Intel- and Alpha-based computers. His plan: get Digital's fragmented business units to line up behind a single effort to push computer hardware and services tied to Windows NT, Microsoft Corp.'s fast-selling operating system for corporations. He says he'll do that by focusing on vertical markets—telecommunications first—and stressing a line of computers stretching from PCs to main-

frames that can run any NT-compatible program off the shelf.

Trouble is, Compaq Computer Corp. has the same idea. On June 23, the giant made a \$3 billion offer to buy computer maker Tandem Computers Inc., which builds large-scale computers. By now, Digital should have a way out ahead. It jumped on the bandwagon early—too early, as it turned out. Microsoft's operating system needed an overhaul before corporate customers were enthused, and Digital's efforts to link its Alpha computers to NT never produced explosive sales. NT is taking off, and Palmer is counting on Claflin to make up lost ground. "Claflin has as good a shot as anyone making a difference," says Steve Milunovich, an analyst with Morgan Stanley Dean Witter Equity Research. "But it's late in the game."

Bruce L. Claflin

BORN

Oct. 10, 1951, Bryn Mawr, Pa.

EDUCATION

Penn State University, A.B.
Political Science, 1973

CAREER

1973-92 Joins IBM, serving in a variety of marketing and sales jobs, ending as assistant to President John E. Oates

1992-95 Heads IBM's ThinkPad business, moving up to run sales, management and marketing for all IBM PCs

1995-97 General Manager of Digital's PC business

1997-present Senior vice-president and general manager of worldwide sales and marketing

OUT OF THE OFFICE

Avid sailor

FAMILY

Married 24 years to Kathleen Claflin
Three children

And investors are growing impatient. After an initial spike in sales because of pent-up demand to replace old Digital computers, sales of the flagship Alpha computers have sputtered from white-hot 87% growth rate in 1995 to a sorry 4% in 1997. Now, the company is facing mounting pressure from shareholders, including a proposal to force the company to consider buyout of itself. Claflin is feeling the heat. "Before he came to Digital, he didn't have to

about board issues and shareholder issues," says Bill L. Fairfield, chief executive of Inacom Corp., a computer retailer and a friend for 15 years. Now, he's directly exposed." The youngest of three rough-and-ready boys from a middle-class family in Adnor, Pa., the former high school basketball player concedes: "At one level, I'm scared. I don't want to fail. But I love the challenge."

Clafin began testing himself at an early age. The summer before his senior year at Penn State University, he bought an old pickup and drove West, just to see whether I was capable of doing things on my own." He landed in Boulder, Colo., where he worked in construction by day and lived in his truck at night. After a few weeks, he moved out because the truck broke down in Utah, so he hopped freight trains for the rest of the summer, riding the rails back to his senior year. After that experience, Clafin says, "I was ready for a challenge. I never wanted to live like that again."

WORLD COM TARGETS. He will no doubt cash his paycheck this year. In the coming months, Clafin has to hammer home the message that Digital has one conspicuous product line, from low-margin routers based on Intel chips to higher-margin computer servers using Digital's powerful Alpha microprocessor. That's all while coordinating a freewheeling sales effort. In the past, customers sometimes dealt with eight Digital reps, one for each business unit.

But no more. To get the sales force on the same board, Clafin has come up with a new mission structure that pays for "selling all of Digital," instead of skewing compensation to favor Alpha computer sales. Insiders say Clafin also plans to abandon the current tactic of boosting sales by focusing on nine broad market segments, ranging from 3-D printing to large corporate databases. Instead, he will launch industry-specific divisions that will focus on companies shifting to Windows NT. The telecom industry is first up: Digital has budgeted \$1 billion to target AT&T, MCI, the Baby Bells, and their suppliers.

Clafin also is pushing Digital to be more responsive to customer requests. Ask Terry Boyd, manager of global computing and telecom services at WorldCom Co. He says Clafin delivered quickly on his promise to simplify Digital's global pricing, ending the patchwork of prices in different countries that has been a long-standing complaint among big customers. "He seems to be making things happen," says Boyd.

The question now is whether Clafin can make things happen quickly enough.

By Paul C. Judge in Boston



EBBERS: Chasing the industry's holy grail of one-stop shopping for telecom.

TELECOMMUNICATIONS

MAKING WORLD COM LIVE UP TO ITS NAME

CEO Ebbers is expanding its reach with local and Net service

Bernard J. Ebbers is not your typical telecommunications pioneer. He doesn't have a cellular phone or a pager. He doesn't even use E-mail or voice mail to communicate with executives at WorldCom Inc., the \$5.6 billion telecommunications company he heads. Instead, the 55-year-old president and CEO spends a good part of his day walking around the company's Jackson (Miss.) headquarters talking to employees. "When you come to the table with a PE [physical education] degree like I do," Ebbers jokes, "you don't know a lot about the technical stuff."

Don't let the self-deprecating charm fool you. In the past 12 years, Ebbers has done nearly 50 mergers and acquisitions to build WorldCom into the fourth-largest long-distance company in the U.S. Revenues are expected to grow 30% this year, to \$7.3 billion, with earnings of \$350 million. His boldest move: last year's \$12.5 billion stock deal to

buy local phone competitor MFS Communications Co. That also gave WorldCom a beachhead in cyberspace through UUNET Technologies Inc., the Internet service provider MFS had just bought. Today, WorldCom boasts major local, long-distance, and Internet networks, something not even AT&T can yet claim.

Now, Ebbers has to prove that he can exploit the powerful arsenal he has assembled. It won't be a cakewalk. When WorldCom was just selling long-

WISE PLAY? WorldCom is going to battle absent one big weapon: Wireless communications

distance service, it could rely on a simple sales pitch: Its prices are often 15% below that of its rivals. But now, it has the more complicated task of selling integrated local, long-distance, and Net services to small and medium-size corporations. That requires building a far more sophisticated sales force than the

one it has. "They've done the deals," says Mark Kastan, a vice-president with Merrill Lynch & Co. "Now they have to make them pay."

At the same time, WorldCom is going into battle absent one big weapon: wireless communications. Ebbers insists that corporations don't need cellular phones packaged with their other services, but rivals disagree. "They're beginning to put together some of the pieces, but there are big holes," says Daniel Schulman, AT&T's vice-president for strategy and local marketing. "They're missing a key ingredient called wireless."

Nonsense, says Ebbers. What he believes will be important in the future is owning a chunk of the telephone and Internet infrastructure. So he's focusing on expanding the reach of WorldCom's networks. Ebbers is overseeing a massive building spree, shelling out \$2.5 billion this year—up from \$1.6 billion in 1996—on voice and data networks in the U.S. and Europe, including \$350 million to expand the company's Internet presence. That's about 34% of expected revenue this year vs. some 11% and 20% for AT&T and MCI, respectively.

HIGH SCHOOL COACH. Ebbers' early years hardly marked him as a telecom firebrand. Raised in Edmonton, Alberta, he landed a basketball scholarship at Mississippi College where he earned his PE degree. He coached high school teams for just one year before his entrepreneurial spirit surfaced in 1974 and he bought into a Mississippi hotel. After building up a chain of hotels—he still has investments in some properties—Ebbers and a group of investors started long-distance company LDDS in 1983. Because of his business background, the board asked Ebbers to take over as president two years later when the company was stumbling. He quickly began gobbling up smaller long-distance players.

Ebbers' focus on long distance worked until passage of the Telecommunications Act of 1996. In the newly deregulated era, it was clear the long-distance market would only grow more crowded as such upstarts as Denver-based Qwest Communications International Inc. built new networks and Baby Bells moved into the long-distance turf. Ebbers decided to go after what has become the industry's holy grail: offering customers "one-stop shopping" for all their telecom services.

So WorldCom, which changed its name from LDDS WorldCom earlier this year, looked to expand beyond offering long-distance voice and data. Ebbers

landed MFS, which gave WorldCom first-class local networks—now up and running in 41 U.S. cities—and a national Internet backbone.

But for all those pluses, the MFS deal also forced Ebbers to break a rule in his M&A playbook. While he had promised investors that all acquisitions would add to WorldCom's bottom line, the MFS transaction diluted earnings. MFS was still operating at a loss, and

capture market share or be global. Ebbers. "Our goal is to be the No. 1 stock on Wall Street."

To keep that stock price rocketing skyward, Ebbers has to make the deal pay off quickly. UBS Securities analyst Linda B. Meltzer expects WorldCom will save \$350 million a year by combining the network operations of the three companies. Estimates the total cost savings the next five years could top \$1 billion.

Longer term, the real challenge is to translate the company's rich base into big revenue gains. WorldCom is targeting small and midsize corporations, hoping to provide them with a complete list of telecom services. In June, the company is selling a package that includes long-distance, local, and Internet service in 28 cities. The offering will expand to 46 cities by yearend.

But don't expect WorldCom to spend much time wooing the corporate multinational customer. Competition from big telecom players makes that end of the market hotly contested, and margins are thin. Still, Ebbers plans to continue WorldCom's growth. While he does not think the company needs a wireless partner for now, he's negotiating future long-distance local acquisitions. And Ebbers has no need to pursue a global alliance. While MCI is selling out to Pacific Telecommunications and both MCI and Sprint have global alliances, WorldCom is building a network worldwide, largely on its own.

FOR SALE SIGN? Many competitors and industry pros, however, think it's only a matter of time before WorldCom finds an international dance partner. Experts point to WorldCom and Cable & Wireless Corp. and Cable & Wireless. WorldCom already is teaming up with Cable & Wireless in construction of a transatlantic cable. "Eventually, this industry will consolidate into three or four integrated players," says John E. Lathrop, an analyst at Boston-based Massachusetts Financial Services Co., one of WorldCom's largest shareholders.

For his part, Ebbers, who owns 10 million WorldCom shares, worth \$100 million, says that his company may be too big for most players to swallow. WorldCom's market capitalization is some \$30 billion. But he doesn't want to sell if the price is right.

For now, though, Ebbers must prove he's as good at managing a global business as he has been at building one.

By Amy Barrett in Washington, D.C.
Peter Elstrom in New York

Moving into the Big Leagues

DECEMBER, 1996

Acquires local phone competitor MFS Communications in a \$12.5 billion stock transaction. The deal also gives WorldCom a stake in cyberspace via Internet provider UUNET Technologies, which had just been bought by MFS.



JANUARY, 1995

Pays \$2.5 billion in cash for Williams Telecommunications Group, giving the company an 11,000-mile network of fiber-optic and wireless facilities and a big business supplying capacity to other long-distance carriers.



DECEMBER, 1994

Lands a \$900 million stock swap merger with IDB Communications Group, a long-distance and satellite company. This gives WorldCom undersea cable capacity, as well as networks in Germany and Britain.



SEPTEMBER, 1993

Strikes a three-way, \$1.2 billion merger with John Kluge's Metromedia Communications and Resurgens Communications Group, adding major long-distance capacity in the Northeast U.S. and California.



DATA, COMPANY REPORTS

amortizing goodwill from the deal will cost about \$440 million annually for the next five years. That sent earnings in the first quarter, ended Mar. 31, down 50%, to \$43 million. "I swallowed deep, ducked my head, and did the deal," says Ebbers.

Despite the financial hit from the MFS acquisition, WorldCom has remained a Wall Street darling. The company's annual report boasts that \$100 invested in WorldCom stock at the end of 1989 was worth \$2,214 at the end of 1996, vs. \$162 for AT&T investors and \$151 for MCI Communications Corp. shareholders. The stock, now around \$32, is up 20% so far this year. "Our goal is not to

EDITED BY OTIS PORT

ROBOT ROLLS ON THE RED PLANET

JULY 4TH, AS INDEPENDENCE Day parades were winding down on the East Coast, NASA's Pathfinder probe was heading for a landing on Mars in the Ares Vallis, an ancient floodplain. The \$200 million vehicle, launched last December, is set to become the first spacecraft to touch down on the Red Planet since two Viking probes landed there in 1976. It won't be the last. NASA has a whole series of Mars missions in the works, including a satellite to arrive in September. The program stretches through 2005. That's when scientists may finally get their hands on the first rocks from another planet—which could settle the issue of whether there is, or ever has been, life on Mars. The findings coming up in 1998 and 1999 were planned before last summer's claim of microfossils had been found in Martian meteorites,

so those probes won't collect rocks. The missions scheduled for 2001 and 2003 will, but NASA doesn't plan to fly the rocks back right away.

Pathfinder's timetable called for it to greet the Martian sunrise at 5 p.m. EDT July 4 by blinking open its two eyes—dual camera lenses for taking 3-D pictures—and hunting for the sun. Then it can orient its antenna properly for communications with Earth. After mission controllers ran checks on Pathfinder's systems, they planned to tell Sojourner, a file-drawer-size robot vehicle, to get its six wheels rolling and try the Martian soil. If all went according to plan, the first pictures were slated to be on TV around 8 p.m.

The Pathfinder lander is mainly an automated weather station. It was to sample

the Martian atmosphere on the way down, then take regular readings in coming weeks of wind speed and direction with a small wind sock. Airborne dust will also be measured, and the camera will track clouds and analyze humidity, using special fil-



ters sensitive to water vapor.

Other filters will snap over the twin lenses to peer beneath the skin of Martian rock outcroppings—satellite remote-sensing technology brought down to the sur-

face. This will help scientists decide where to send Sojourner. The wheeled robot carries an alpha-proton X-ray spectrometer (APXS) that can detect even trace amounts of minerals and other elements, including carbon and oxygen. The APXS bombards a rock or patch of soil with alpha particles, generating X-ray and proton emissions that reveal chemical composition.

All this technology stems from a far-flung international collaboration. For example, Pathfinder's \$6 million camera system was developed by a team of 40-odd U.S., German, and Danish scientists headed by Peter H. Smith at the University of Arizona's Lunar & Planetary Laboratory. "Light," he says, "just turns me on."

Smith, an optics expert, is now working on a microscope camera for Sojourner's successor. It should furnish more clues to help unlock the secrets of our mysterious red neighbor.

IS THERE ONE PIECE

IN 1990, THE PENTAGON dreamed for a reusable spacecraft that could climb into orbit in one piece, without jettisoning off expensive booster rockets on the way. This single-stage-to-orbit (SSTO) approach would help warships operate more like airlines and slash the costs of putting payloads into orbit—to less than \$1,000 a pound, or a fraction of the shuttle's \$12,500 per pound costs.

By 1995, McDonnell Douglas Corp. was flying the DC-prototypes of a craft that landed on its tail. After a



dozen low-altitude flights, NASA took over the program last year and rejected the DC-X. For the next-generation SSTO, dubbed X-33, NASA picked Lockheed Martin Corp.'s "lifting body" design, or flying wedge. It was a gamble. Lockheed proposed using a radically different "aerospike" engine. The name stems from a nail-shaped plug in the rocket's tail that im-

proves efficiency by compensating for changes in outside air pressure as the rocket climbs through the atmosphere.

The aerospike engine was developed in the 1960s by Rocketdyne, but NASA then rejected it as risky technology. So an

aerospike rocket has never flown. Lockheed plans to change that next month. A scale-model aerospike will take to the air for the first time, mounted on an SR-71 jet. Meanwhile, Lockheed says the X-33's maiden flight, originally set for January, 1999, will slip a couple of months, into springtime. The flight tests should still end on schedule, however.

INNOVATIONS

■ After problems with its H-2 rocket, Japan's space program got back on track last February when the new M-5 booster put the Halca science satellite into orbit. Now, Japan's Institute of Space & Astronautical Science is getting ready for its own mission to Mars. Next year, it plans to place a satellite called Planet-B in orbit around the Red Planet.

■ Stardust is the fanciful name for a NASA mission that will rendezvous in 2004 with Comet Wild-2, some 250 million miles from earth. The probe won't really collect stardust, but it will bring home dust from the comet's tail—some of the oldest matter in the universe—in 2006.



An anniversary gala will be held the week of July 7-13 at the Tournament Players Club of Michigan, where Raymond Floyd defends his title in the FORD SENIOR PLAYERS Championship.

The tournament, which attracts the strongest field of the Senior PGA TOUR season, first was played 15 years ago – in 1983 – at Canterbury Golf Club in Cleveland. Miller Barber won the inaugural by one stroke over Gene Littler, earning the then-princely sum of \$40,000 from the \$250,000 purse. By contrast, this year's field is competing for a \$1.8 million purse, the largest in Senior TOUR history, and a \$270,000 first prize.

Seventy-eight players will comprise the field for the 1997 FORD SENIOR PLAYERS Championship. In 1983, in what was the fourth year of the still-developing Senior TOUR, the number



SENIOR PLAYERS CHAMPIONSHIP

was 50. The depth and quality of the field, as well as the level of competition, has grown markedly over the past 15 years.

Participants earn entry into the FORD SENIOR PLAYERS Championship on the basis of points accumulated through the preceding event, which is the Kroger Senior Classic. The competition to gain admission to this prestigious Senior TOUR event has become increasingly keen.

Last year, Floyd won his third senior major championship by two

strokes over Hale Irwin. He shared the second-round lead with Irwin and John Bland, then moved in front to stay with a 7-under-par 65 that gave him a four-stroke lead through 54 holes. A closing 73 was good enough for his final margin of victory.

"The thing that surprised me was the scores," Floyd said following his win. "I would never have believed you if you'd told me that two guys would be under par double figures on this golf course. It just shows the caliber of play on the Senior TOUR."

Through June 8, the 54-year-old Floyd had earned 13 Senior TOUR victories, including the 1994 Tradition and 1995 PGA Seniors' Championships. He also counts the 1976 Masters, 1969 and 1981 PGA Championships and the 1986 U.S. Open title among 22 PGA TOUR victories.

successful defense at the TPC of Dearborn, located in the Detroit suburb of Dearborn, would move Floyd into an exclusive company. Only Arnold Palmer (1984-85) and Dave Stockton (1982 and 1994) have won two FORD SENIOR PLAYERS Championships. This is a special week on the Senior TOUR," said PGA TOUR Commissioner Tim Finchem. "As the FORD SENIOR PLAYERS Championship usually attracts the strongest field in the FORD SENIOR PLAYERS Championship features the best field in the Senior TOUR season.

A victory in the FORD SENIOR PLAYERS Championship is something in which the winner takes great pride," Finchem added. "We also take great pride in our association with the PGA TOUR, which became tournament sponsor in 1993, and in the fact that \$2.8 million has been distributed through the FORD SENIOR PLAYERS Championship to Michigan charities." In his 10 years at Canterbury concluding with a Chi Chi Rodriguez victory in the 1986 FORD SENIOR PLAYERS Championship.

The next three tournaments were played in Ponte Vedra Beach, FL, near PGA TOUR headquarters. The winners were Gary Player at Sawgrass Country Club (1987), followed by Billy Casper and Orville Moody at the TPC at Sawgrass (Valley Course).

In 1990, TPC of Michigan course designer Jack Nicklaus set the standard by which all subsequent FORD SENIOR PLAYERS Championships participants have been measured: an average 27-under-par 261, the lowest hole score in Senior TOUR history. But Nicklaus established his record at Dearborn Country Club. That was only the first time the tournament was held at that facility, the year before it moved to the 6,876-yard, par-72 Tournament Players Club.

Former club professional Jim Albus was a surprise winner of the TPC of Michigan inaugural in 1991. Jim Colbert, Senior TOUR Player of the Year for 1995 and 1996, and J.C.

Snad each earned their first senior title at the FORD SENIOR PLAYERS Championship. Colbert was the winner in 1993, Snad in 1995. The land on which the TPC of Michigan sits was purchased in 1915

FORD SENIOR PLAYERS Championship Television Schedule

Thursday, July 10
First Round of Competition
ESPN, 2:00-5:00 p.m. EDT

Friday, July 11
Second Round of Competition
ESPN, 2:00-5:00 p.m. EDT

Saturday, July 12
Third Round of Competition
ABC, 2:30-4:30 p.m. EDT

Sunday, July 13
Final Round of Competition
ABC, 4:00-6:00 p.m. EDT



by Henry Ford, whose hometown was Dearborn. The TPC, situated just 15 minutes from downtown Detroit, enjoys yet another unique distinction: it was the second facility to receive the John James Audubon Environmental Steward Award for its efforts to restore a previously degraded area into a nationally significant model of ecological restoration.

The Tournament Players Club is part of the Ford Motor Land Development Corporation's Fairlane Complex.

"The FORD SENIOR PLAYERS Championship is an exciting event for the Southeast Michigan community to

participate in each year," said tournament chairman Peter Pestillo, Ford's Executive Vice President, Corporate Relations. "The Tournament Players Club sits in the shadow of Ford's world headquarters on land purchased decades ago by Henry Ford, making it a natural tie for Ford Motor Company involvement.

"Through this tournament, Ford and its employees have an additional opportunity to help charities in Southeast Michigan, as it does in other communities around the world where Ford does business," Pestillo continued. "Since 1993, with Ford involvement, the tournament has experienced tremendous growth in proceeds going to worthwhile charities.

"We're proud that the FORD SENIOR PLAYERS Championship hosts many of golf's legends at such a premier location. We hope this event continues to grow in popularity with the players, the fans and the community."

Who will emerge as 1997 champion of the FORD SENIOR PLAYERS Championship? Will Raymond Floyd be able to defend his title? The second week of July will provide the answers.

FORD SENIOR PLAYERS Championship Results

CANTERBURY GOLF CLUB, CLEVELAND, OH

1983	Miller Barber	One stroke over Gene Littler
1984	Arnold Palmer	Three strokes over Peter Thomson
1985	Arnold Palmer	11 strokes over Miller Barber, Lee Elder, Gene Littler and Charles Owens
1986	Chi Chi Rodriguez	Two strokes over Bruce Crampton

SAWGRASS COUNTRY CLUB, PONTE VEDRA BEACH, FL

1987	Gary Player	One stroke over Bruce Crampton and Chi Chi Rodriguez
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TPC AT SAWGRASS (VALLEY COURSE), PONTE VEDRA BEACH, FL

1988	Billy Casper	Two strokes over Al Geiberger
1989	Orville Moody	Two strokes over Charles Coody

DEARBORN COUNTRY CLUB, DEARBORN, MI

1990	Jack Nicklaus	Six strokes over Lee Trevino
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TPC OF MICHIGAN, DEARBORN, MI

1991	Jim Albus	Three strokes over Bob Charles, Dave Hill and Charles Coody
1992	Dave Stockton	One stroke over J.C. Sned and Lee Trevino
1993	Jim Colbert	One stroke over Raymond Floyd
1994	Dave Stockton	Six strokes over Jim Albus
1995	J.C. Sned	Won playoff over Jack Nicklaus
1996	Raymond Floyd	Two strokes over Hale Irwin

IS CANCER A CONTAGIOUS DISEASE? NO...

...but research reveals new links between everyday bugs and life-threatening diseases

In late June, a report in *The New England Journal of Medicine* roused infectious-disease experts around the world. It described how a 12-year nationwide vaccination program against rampant hepatitis B in Taiwan brought a decrease in cases of childhood liver cancer. It was a remarkable development: An effort to combat an infectious disease had also proven effective against cancer.

Cancer and contagion. That's a terrifying association—one that most doctors are loath to make. It's also misleading by any conventional definition of contagion. Nonetheless, a growing and highly respected community of researchers in cancer and infectious diseases believes that microorganisms—viruses, bacteria, and parasites—play a significant role in cancer, heart disease, diabetes, and other illnesses that are not traditionally regarded as infectious. In essence, the bugs are "cofactors." In that regard, the Taiwan study "is very significant," says Dr. Anthony S. Fauci, head of the National Institute of Allergy & Infectious Diseases.

EARLY HINTS. The idea is not new. A hundred years ago, doctors noted a connection between cervical cancer and sexual promiscuity that transcended mere coincidence. By the 1960s, a connection between microbes and animal cancers had become well established, but scientists failed to demonstrate the same association in humans. Even today, some researchers resist the notion of infectious cofactors because—in the case of cancer—hundreds of millions of people worldwide carry the

suspect agents, yet don't get sick.

Nevertheless, scientists armed with exceedingly powerful research tools are drawing new microbial connections to noninfectious diseases at a faster rate than ever before. For the first time, it is possible to make absolute associations between some microbes and cancer, says Fauci. The link between hepatitis B and

in Africa. And Kaposi's sarcoma virus (KSHV), discovered in 1992 by Patrick Moore and Yuan Chang at Columbia University, appears to be a cause of Kaposi's sarcoma, a cancer that is a scourge of AIDS patients. Last month, an article in *Science* further linked KSHV with a more common cancer of the blood called multiple myeloma (table).

None of these associations is simple or transparent. In this case, cancer and heart disease have little in common with classic plague pests. Malaria, cholera, bubonic plague, and virulent staphylococcus infections are caused by well-known parasites, viruses, or bacteria. And the pathways the microbes use to wreak their devastation are well understood.

In contrast, with complex illnesses such as cancer, heart disease, diabetes, infection seems to cause problems only when combined with suppressed immune system, the presence of a chemical agent, or a genetic predisposition. In most cases "we don't know what these cofactors are," says Harvard Medical School

professor Martin S. Hirsch. "But those in the field think most diseases turn out to have infectious cofactors."

Not all scientists agree—particularly when it comes to mainstream cancers. Robert A. Weinberg, a member of the Whitehead Institute for Biomedical Research in Cambridge, Mass., says such theories were well explored in the 1960s and '70s. And with a few important exceptions—HPV, hepatitis B, and Kaposi's sarcoma virus—they simply did not pan out. In America, Weinberg

THE INSIDIOUS ROLE OF MICROBES

A growing body of research suggests that while diseases such as cancer are not contagious, various types of commonly transmitted viruses or bacteria can set the stage for disease onset. Some examples:

AGENT	SUSPECTED LINK
CHLAMYDIA PNEUMONIAE	Artery-clogging plaques
CYTOMEGALOVIRUS (CMV)	Heart disease
EPSTEIN-BARR VIRUS (EBV)	Burkitt's lymphoma nasopharyngeal cancer
HELICOBACTER PYLORI	Ulcers, stomach cancer
HUMAN PAPILLOMAVIRUS (HPV)	Cervical cancer
HEPATITIS B (pictured here)	Liver cancer
HTLV-1	Leukemia
KAPOSI'S SARCOMA HERPES VIRUS (KSHV)	Kaposi's sarcoma, multiple myeloma

liver cancer, he says, is a "slam dunk." The same is true of human papillomavirus (HPV) and cervical cancer.

Researchers have drawn weaker but no less tantalizing connections between *Helicobacter pylori*—the bacterium that causes ulcers—and two types of stomach cancer. The common parasite *Chlamydia pneumoniae* could be associated with cardiovascular diseases. In Japan, a retrovirus called HTLV-1 has long been linked with leukemia. Epstein-Barr virus (EBV) is associated with a common lymphoma

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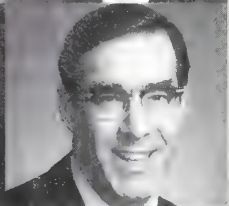
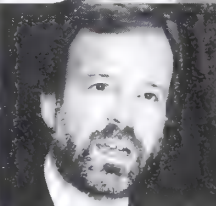
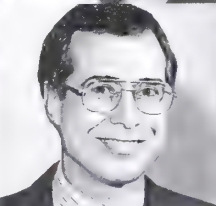
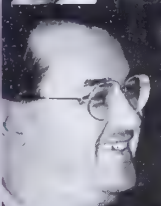
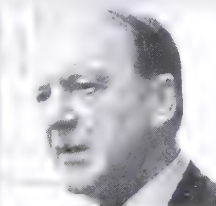
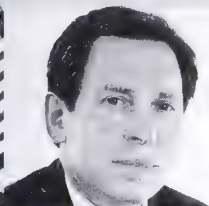
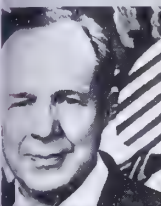
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says, the cancers linked with these bugs make up just a few percent of all cancer cases. He believes most human cancers ultimately will be traced to the actions of certain cancer-causing genes, not to infectious organisms.

It's true that few virologists actively hunt for microbial causes of breast or prostate cancer. But if the scope of inquiry is widened to include less developed countries, the scale of microbial involvement is not trivial. The International Agency for Research on Cancer, an arm of the World Health Organization, believes microbe-linked cancers—mainly cervical and liver—make up 20% of all cancers in the Third World.

And even in the U.S., the failure to find microbial cofactors in major diseases may lie with the researchers. Not all cancer-associated viruses reside in the tumor cell, says James Berenson, professor of medicine at the University of California at Los Angeles and co-author of the recent *Science* article on Kaposi's sarcoma herpes virus. Berenson says this microbe is associated with 100% of multiple myeloma cases. But it's not in the cancer cells. It's in a type of immune cell in the bone marrow called a dendritic cell.

DOUBLE WHAMMY. That makes the virus doubly insidious, he says. Once the virus is inside the dendritic cell, Berenson believes, it "down-regulates" a part of the cell that presents foreign antigens to the immune system. In effect, it becomes invisible to other immune cells and can't be attacked. "So not only does the virus drive the tumor," Berenson speculates, "it also messes up the immune system."

Researchers say cancer-linked microbial infections fall into two camps. On one side are viruses that trigger cancer by switching off human genes that suppress tumors. "Such viruses cause the cell to lose normal growth control," says Walter Eckhart, director of the Salk Institute's Cancer Center in La Jolla, Calif. For example, HPV makes proteins that interfere with two tumor-suppressor genes, the p-53 gene and the retinoblastoma gene, according to Howard D. Strickler, a National Cancer Institute researcher.

In the other camp are microbes that cause irritation and can trigger cancer when the body's response goes astray. In the case of *Helicobacter pylori*, for example, stomach cells mutate to avoid damage from the bacterium, says Julie Parsonnet, associate professor of medicine at Stanford University. The muta-

also be fertile ground for finding infectious cofactors. "A wide variety of microbial agents can cause diseases as diabetes when they are injected into animals," notes Michael Oldstone, professor of virology and immunology at Scripps Research Institute in La Jolla, Calif. There are hints of similar processes in humans.

Alvin Friedman-Krueger, professor of dermatology and microbiology at New York University Medical Center: "There are new agents waiting to be discovered."

Rethinking the microbial basis of diseases has implications for public health and for disease treatment and prevention. Consider Chlamydia, No. 1 killer worldwide for years, researchers noted the

presence of Chlamydia pneumoniae in arteries of heart patients and in plaques that cause heart disease. Now, doctors are looking at the infection as a therapeutic target. In a two-year trial at George's Hospital in London, cardiologist Sandeep Gupta gave antibiotics to 40 patients with high levels of antibodies to chlamydia while

administering a placebo to 40 other patients. He believed the high antibody presence might signal a chronic infection. And he hoped that attacking it with an antibiotic would reduce the key "marker" in the blood, such as inflammatory markers and clotting agents.

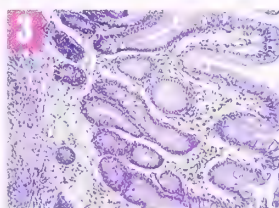
The results: The drugs led to reduced levels of chlamydia antibodies and other markers. What's more, says Gupta, recipients of the drugs suffered fewer subsequent heart attacks. If larger studies bear this out, "it will open a whole new area for the treatment of heart disease by antibiotics," he says. That could be especially useful in the Third World "because traditional treatments like angioplasty are so expensive."

Research into microbe-linked cancer could provide a much needed basic disease screening. A precancerous condition called cervical dysplasia strikes 600,000 to 1 million American women

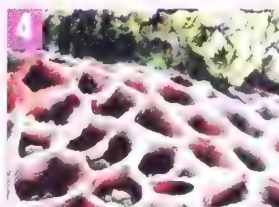
A PLAUSIBLE LEAP FROM BACTERIA TO CANCER



1 The bacterium called *Helicobacter pylori* may be passed from unwashed hands to mouths in day-care centers. Some scientists say flies may deposit bacteria on food.



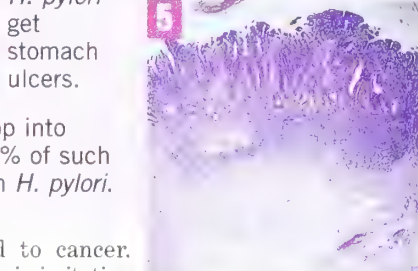
2 *H. pylori* is found in stomachs of a quarter of all U.S. adults. Third world infection rates are higher.



3 The bacterium causes inflammation of the mucous membrane of the stomach, called gastritis.

4 Gastritis may develop into ulcers. About 20% of people infected with *H. pylori* get stomach ulcers.

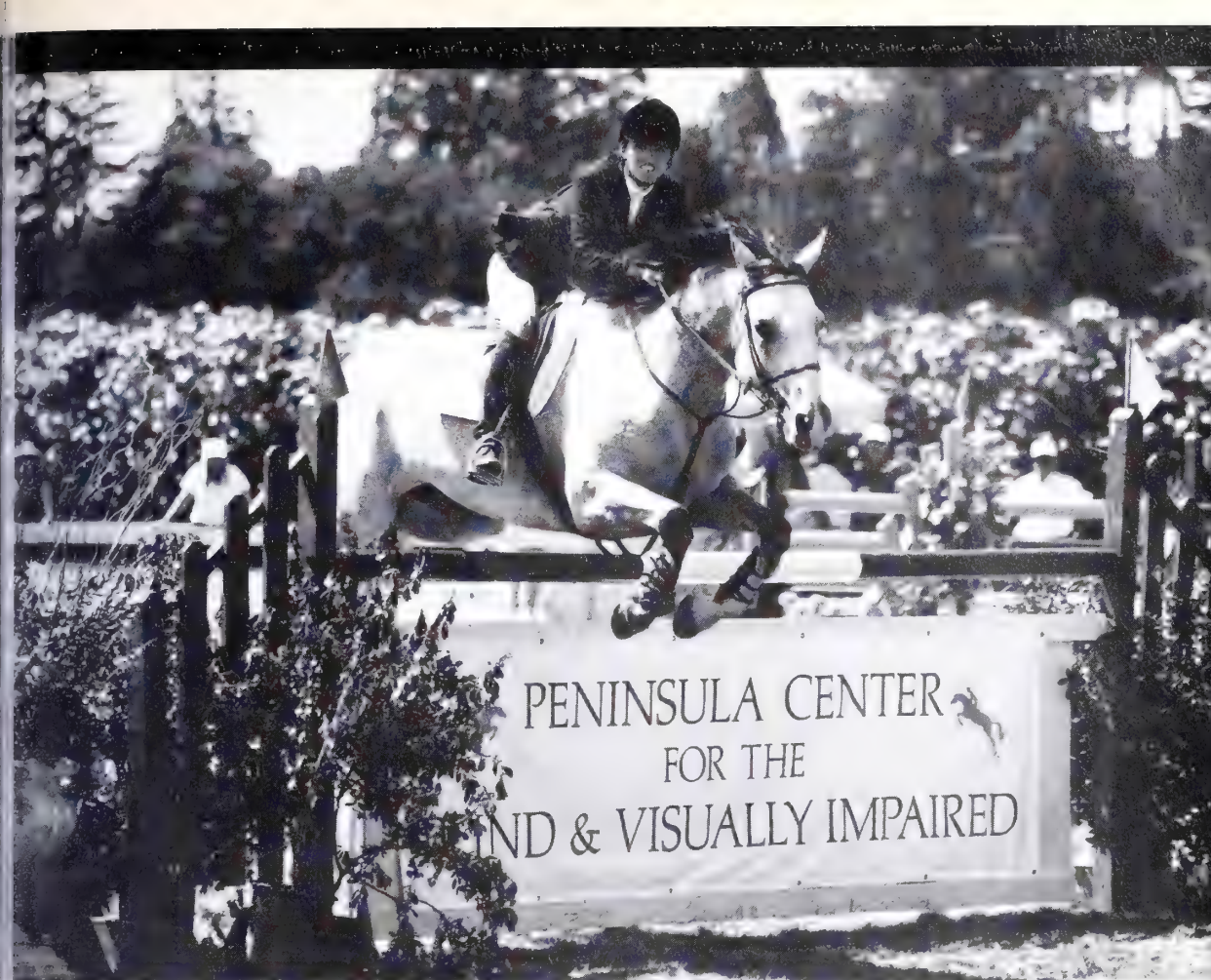
5 Gastritis can also develop into stomach cancer. Some 50% of such cancers may be linked with *H. pylori*.



tion can lead to cancer. Similarly, chronic irritation from schistosomiasis, a parasitic killer in Africa, Asia, and Latin America, may cause bladder cancer. And a flatworm called the liver fluke may cause liver and biliary cancers.

In this camp, *H. pylori* is among the most pernicious microbes. But its role in cancer remains controversial. That galls Peter G. Isaacson, head of histopathology at University College London Medical School, who says that at least one type of malignant lymphoma under investigation "arises in the stomach in the setting of *H. pylori* inflammation, and only there." Why do others doubt it? In part because the bug infects millions of people, while only a few get cancer. But therapeutic results should dispel their doubts, Isaacson argues. In 70% of *H. pylori*-infected patients who have the lymphoma, treatment with appropriate antibiotics leads to regression, he claims.

Multiple sclerosis and diabetes may



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Issue Date:

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each year, notes John Curtin, associate attending surgeon at Memorial Sloan-Kettering Cancer Center in New York. "You can already use human papillomavirus as a discriminator between high-risk and low-risk groups," he argues.

Disease-causing bugs may be vulnerable to vaccination programs, on the model of Taiwan's battle with hepatitis B. Drugmakers are now scrambling to develop vaccines against HPV and other cancer-linked viruses. MedImmune Inc. in Gaithersburg, Md., has begun clinical trials for an HPV vaccine. Likewise, biotech startup Cantab Pharmaceuticals Research Ltd. in Cambridge, England, is doing preclinical work on three different therapeutic vaccines to attack genital warts and cervical cancer. Cantab sees the possibility for 2.5 million patients worldwide, with yearly sales as high as \$490 million. "Basically, everyone who has sex is at risk," says Joel M. Palefsky, associate professor of laboratory medicine at the University of California at San Francisco.

While success stories are still rare, the idea of treating precancerous conditions with antiviral drugs is gaining currency. Dr. Susan Krown, a Kaposi's sarcoma specialist at Sloan-Kettering, cites anecdotal evidence that the use of anti-herpes drugs could thwart tumors in patients who carry the Kaposi's sarcoma virus but haven't developed cancer.

In the hunt for microbial cofactors, researchers are faced with many perplexing issues. Why do common infections, on rare occasions, produce tragic outcomes? What therapeutic advances can researchers hope for in microbe-linked cancer, when viruses such as herpes and HPV are almost impossible to cure? "Antiviral therapy is still in an infant stage compared with antibacterial work," says NYU's Friedman-Kien.

Despite these hurdles, most researchers are optimistic. In the developing world, where pathogens may play a larger role in certain widespread cancers, prevention programs that target infectious diseases could have a huge impact. So could continuing research on pathogens involved in such unilluminated ills as diabetes and multiple sclerosis.

Researchers can count on accelerated discovery. In rapid succession, scientists have identified eight distinct herpes viruses and linked all but one with specific ills. More than 70 types of human papillomaviruses have been found. Not all have even been named. "This is an extraordinary time," says the NCI's Strickler. As scientists analyze the link between microbes and disease, they're bound to find new ways to intervene.

By Neil Gross, with Naomi Freundlich in New York and Heidi Dawley in London.

Government

INDUSTRIAL ESPIONAGE

CORPORATE SPIES FEEL A STING

The feds get serious, but is a new law tough enough?

To hear the feds tell it, Kai-Lo Hsu's scheme was every company's worst nightmare. As technical director of Taiwan's Yuen Foong Paper Co., which has been trying to diversify into biotech, Hsu allegedly negotiated for more than a year to get a peek at confidential data about Bristol-Myers Squibb Co.'s blockbuster cancer drug, Taxol. The deal with a man who called himself a "technology-information broker" was to be sealed at a secret June 14 meeting in a suite at Philadelphia's posh Four Seasons Hotel.

Broker John R. Hartmann was accompanied by a Bristol-Myers scientist with internal documents about Taxol, which had cost several hundred million dollars to develop and was now paying off: 1996 sales had reached \$813 million. Hsu brought along Chester S. Ho, a biochemist and professor at a Taiwan university, and a woman who allegedly represented the real buyer, a large, unidentified company. Knocks on the door halted the meeting twice. They were innocent intrusions by hotel workers. But the third interruption wasn't the chambermaid: FBI agents, who had been videotaping the meeting, moved in and arrested Hsu and Ho. The two had walked into an FBI sting. Hsu was charged with attempting to steal trade secrets and commercial bribery, among other counts. Ho was charged with aiding commercial bribery and conspiracy. No charges were filed against the woman with Hsu and Ho, and the FBI says its probe is continuing. A spokesman for Yuen Foong says the company was entrapped. Lawyers for Hsu and Ho say their clients will fight the charges.

The Philly sting is the second set up by the FBI since the Economic Espionage Act of 1996, passed in October, made theft of trade secrets a federal crime. The law was sold as a way to crack down on foreign intelligence services that have come in from the cold war and turned to economic snooping. It also was supposed to put teeth into the punishment for such crimes, with penalties as high as 25 years in jail and \$10 million in fines for foreign-government spies and lesser sanctions for cases involving foreign civilians and domestic spies. **"NEVER LOOKED."** Already, however, questions are being raised as to whether the penalties likely to be imposed are sufficiently severe to act as a deterrent. "Companies that want to see people suffer greatly are going to be disappointed," says Ira S. Winkler, author of *Corporate Espionage*.

There's no question that the Espionage Act deals head-on with a growing menace to American business that the feds could previously fight only indirectly—by using laws against mail and interstate shipment of stolen goods. A fresh approach was needed to counter the rapid growth in the loss of valuable trade secrets, a crime that

TECH WAR Global intelligence agencies have plunged into industrial spying. In 1996, the FBI had 800 pending probes of thefts by foreign companies or governments—double 1994's figure.

by increasing business use of the t. A survey released last year American Society for Industrial Security (ASIS) showed a 323% increase in incidents from 1992 to 1995 (chart) estimated annual loss to U.S. companies of \$25 billion. "Everybody is looking to the U.S. to solve their tech problems," says N. MacDonnell, managing partner at National Security Institute, a Westborough (Mass.) consulting firm. "And what you get is that the cost of stealing is free."

In the new world of global competitiveness, foreign intelligence services have plunged into industrial espionage with a vengeance. In 1996, the FBI reported 800

business data Russian spooks had gathered. The Russian President insisted that the council "improve the procedures for using the information acquired."

It's not clear that the new law will be effective against corporate Mata Haris. Foes the CIA identified last year as the most aggressive—France, Israel, China, Russia, Iran, and Cuba—often operate overseas, usually beyond the law's clutches. Lockheed Martin Corp. officials, for instance, think foreign operatives were behind an unsolved burglary in the company's Geneva office in late 1995. Computers and other electronic gear that could have easily been sold on the street were ignored, while files with program, financial, and customer data were taken.

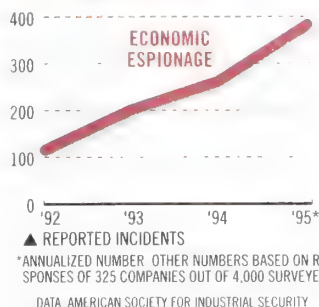
Even if the foreigners work on U.S.

soil, their sophisticated techniques, from infiltration to eavesdropping to cyber intrusions, are difficult to detect. "You only know about their failures," says John D. Glover, Bristol-Myers' vice-president for corporate security. "The successes you don't know about." And to impose the law's stiffest sanctions, the feds face a high hurdle—showing that trade-secret thefts "were actually at the behest of a foreign government," says Peter J. Toren, the

Justice Dept.'s top litigator for intellectual-property crimes.

As a result, the Espionage Act may be most effective against American companies and individuals, who are responsible for the bulk of the thefts, according to the ASIS survey. Take the first case under the new law. A contract employee for PPG Industries Inc., Patrick Worthing, tried to sell Owens-Corning secrets about PPG's fiberglass formulas and other proprietary information. But Owens-Corning, which got help from PPG several

SPIES, SPIES, EVERYWHERE



years earlier when two European employees tried to peddle some of its trade secrets, promptly contacted PPG. The FBI was called in. Last Dec. 7, the FBI arrested Worthing and his older brother, Daniel, near Pittsburgh as they were about to hand over samples of their information for \$1,000 to an FBI agent posing as an Owens-Corning employee.

PUNITIVE DAMAGES? Although PPG estimated the value of what had been stolen at up to \$20 million, Patrick was sentenced on June 5 to only 15 months in jail after pleading guilty to theft of trade secrets. Daniel, who joined the scheme the night before the meeting, had been sentenced earlier to five years' probation, including six months of home detention, after pleading guilty to conspiracy.

Such light sentences may prove typical, limiting the law's value as a deterrent, experts say. They note that because these white-collar defendants are usually first-time offenders, federal sentencing guidelines are lenient. That puts corporate victims in a bind. They can try to jack up sentences by demonstrating to the courts the value of the stolen data. But revealing the theft of important information might "undermine customer and market confidence," says Regis Becker, PPG's security chief.

Despite the law's drawbacks, it clearly has benefits. Because it covers only secrets that companies take "reasonable measures" to safeguard, it encourages caution. In fact, some companies are undertaking trade-secret audits to see what information needs to be protected and what steps to take. In the Worthing case, for example, PPG learned that when faxes or computer printouts were missing, workers thought they simply hadn't come through and would refax or reprint them. No one realized Worthing was walking off with them.

One idea that could give the Espionage Act more punch: Allow companies to file civil suits to win compensation and perhaps triple punitive damages. "That would be a very powerful weapon," says Washington lawyer and fraud expert Thomas W. Brunner. And clearly, U.S. business needs all the ammo it can muster if it is to have any hope of stopping rivals from plundering its secrets.

By Stan Crock in Washington, with Jonathan Moore in Taipei

SETTING TRAPS

Since the Economic Espionage Act was passed last October, the feds have run at least two sting operations

► On June 14, two Taiwanese Americans were busted in Philadelphia for allegedly attempting to buy stolen data about Bristol-Myers Squibb's blockbuster cancer drug, Taxol. The FBI says representatives of the company's Yuen Foong Paper approached an agent who had hung out a shingle as a "technology information broker."

Last year in Pittsburgh, a contract worker for PPG Industries Inc. contacted Owens-Corning, offering to sell trade secrets. The worker was fired from PPG. Owens-Corning informed PPG, which notified the FBI. An FBI agent pretended to be an Owens-Corning representative interested in the information. The worker and his brother were arrested, pleaded guilty, and were sentenced.

DATA: BUSINESS WEEK

probes of thefts by foreign companies or governments—double the 1994 level. Until recently, "we never looked for this stuff," says John F. Lewis Jr., an FBI director in charge of the Industrial Security Div. "We're shocked." At the highest levels of foreign governments vigorously promoting the thefts of local companies, the scope of the problem isn't all that surprising. Unsurprisingly, TV cameras were still rolling, and the criticism last year criticized his council for inefficient use of busi-



EDITED BY EDWARD C. BAIG

IT'S NOT TOO LATE TO GET IN ON FINANCIAL MERGER MANIA

It's wedding season for financial-services firms. Barely a day passes without some announcement of a betrothal. There's Bankers Trust buying Alex. Brown, Zurich Insurance Group of Switzerland taking majority control of investment manager Scudder, Stevens & Clark, Nations-Bank buying San Francisco high-tech investment boutique Montgomery Securities. There have even been rumors of a megaton merger between Citicorp and American Express.

The price-earnings ratios of the financial-services indexes and funds, with their heavy dominance by banks, have been running 12 to 13 times 1998 earnings compared with 19 times for the Standard & Poor's 500. The NASDAQ Bank Index is up 262% since July 1992, while the S&P Financial Index, a grouping of diversified, large-capitalization financial companies, is up 248% for the same period. The S&P 500, meanwhile, has risen 145%.

BREAKDOWN. Amid such gains for financial services, is it too late for investors to get in on the action? The answer depends in part on how you feel about the overall direction of the U.S. economy and stock market. If you believe that low inflation and strong growth can continue, then the market probably can go higher. And the same dynamics that are behind the economy—new technology, global competition, and consolidation—are at work in the financial-services arena.

Couple that with the continuing breakdown of Depression-era legal restrictions

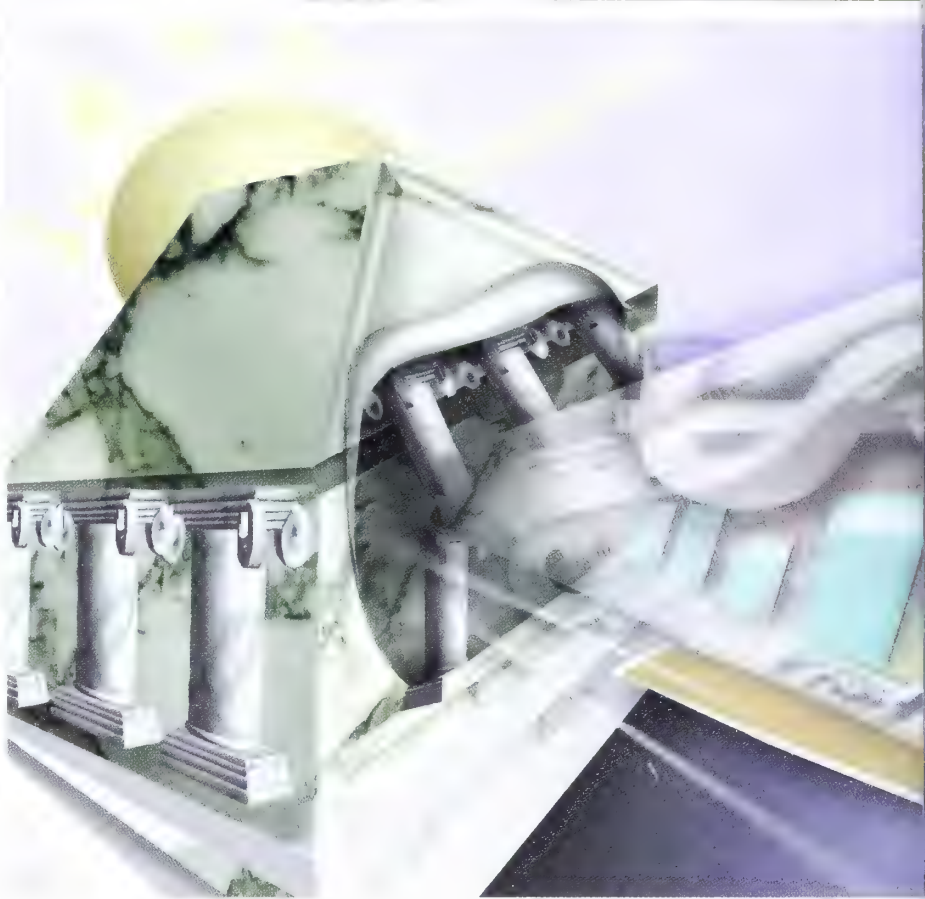
on what commercial and investment banks can do and own, and you have the recipe for more dealmaking among financial firms. "There's a mad scramble by all kinds of players," says George Salem, an analyst at investment firm Gerard Klauer Mattison.

One way to exploit the

Regional Bank fund, which is up 112% over the past three years. That fund is closed to new investors. But Schmidt is still welcoming investors to his Financial Industries fund, which is up 14.2% so far this year. Schmidt, who has 320 companies in his fund, likes several Tennessee

runs the FBR Financial services fund, favors bank thrifts such as Astor Financial and First Chicago, as well as such insurers as SunAmerica and Torch

If funds are not game, you might want to pick the next takeover yourself. That's a



TAKEOVERS

Singling out hot candidates is n

scramble is to find a mutual fund that has been concentrating on America's financial restructuring. For example, manager James Schmidt amassed a stellar track record at the John Hancock

banks such as Union Planters and First Tennessee, as well as New York's GreenPoint Financial, which specializes in low-documentation mortgages. And David Ellison, a former Fidelity fund manager who

business, especially in stock prices of many run target companies already a takeover prey. "You've got companies ing at levels beyond what fundamentals would sup

ns Sanford C. Bernstein
range analyst Sallie
check. Perhaps a better
gy might be to focus on
ayers.
st and foremost in this
is Travelers Group. "It
you a call on consolida-
many industries," says
check, who terms the
"a core financial hold-

over stocks, do it with care.
In the past, all you had to
do was buy the stock of a
midsize bank in a state such
as Florida or North Carolina
and wait for one of the grand
acquirers, like NationsBank
or Barnett Banks, to come
along and make a premium
offer. That can still be the
path to instant riches: The

aging director at Salomon
Brothers.

But with many of the so-
called "superregional" banks
now close to becoming na-
tional franchises, the ap-
petites of these consolidators
are changing. Banks are the
most likely acquirers across
the financial-services indus-
try because they have the

also obvious buyers. Many
have global aspirations but
lack a strong franchise in the
U.S., whose economy is
among the most dynamic in
terms of raising capital. The
Dutch banks ING Barings and
ABN Amro have been active
in the U.S., with ABN Amro
picking up Midwestern
lenders and thrifts and ING
rumored to have looked at
Oppenheimer. Other notable
foreign banks with an acquis-
itive eye include Deutsche
Bank and Swiss Bank, which
recently bought investment
bank Dillon, Read.

RESTRICTIONS. Some analysts
believe that international
banks will pay more for entry
into the U.S. market and
also may not face the same
legal restrictions. That makes
them possible acquirers for
investment banks with a mer-
chant banking presence such
as Donaldson, Lufkin & Jen-
rette. DLJ's stock is double
what it was a year ago, with
most of the gains occurring
this year.

Another favorite takeover
target for banks, insurers,
and securities firms alike are
mutual-fund operators, which
have been at the epicenter of
the greatest bull market in
history. That explains why
white-shoe banker J.P. Mor-
gan is eyeing the American
Century family of funds and
why Mellon Bank bought out
Dreyfus. It also goes a long
way to explain the perennial
rumors surrounding Ameri-
can Express, which has a
valuable property in its fi-
nancial-planning and adviso-
ry unit. It's also the reason
General Electric's acquisitive
Capital Services unit has
been snapping up asset-man-
agement firms with abandon.

With more than 12,000
banks, thrifts, insur-
ers, and broker-
ages in business,
there's no shortage
of investment candidates.
As long as the overall mar-
ket and economy remain
healthy, it's likely that finan-
cial-services stocks will con-
tinue their ride for a while
longer.

Tim Smart

Playing the Changing World of Financial Services

STOCKS TO WATCH...

TRAVELERS GROUP (15)* Conglomerate that's into
securities, insurance, and consumer finance.

MERCANTILE BANCORP (13) Strong Midwestern lender
often mentioned as a possible takeover target.

UNION PLANTERS (13) Regional bank with \$15 billion in
assets and base in fast-growing Tennessee.

T. ROWE PRICE (23) Prestigious fund manager. Could be
just the ticket for an acquisitive bank.

LEGG MASON (19) Tech and health-care investment
banking boutique. May be merger material.

AMERICAN EXPRESS (16) Big card issuer is rebounding.
Talked merger with Citicorp. Who'll be next?

...FUNDS TO CONSIDER

HANCOCK FINANCIAL INDUSTRIES James Schmidt has a
stellar record at Hancock's regional bank fund.

DAVIS FINANCIAL Focuses on big-cap stocks and has
returned 15.2% annually for the past five years.

FBR FINANCIAL SERVICES Former Fidelity standout David
Ellison runs this newish fund. Heavy on banks.

*Price-earnings ratio, estimated 1998 earnings

DATA: BUSINESS WEEK

Under the aggressive
ership of Sanford Weill,
elers has pulled off large
isitions in the brokerage
stry, consumer finance,
insurance. Weill's empire
des Shearson, Commer-
Credit, and Aetna's prop-
casualty units, which
added to Travelers' earn-

stock of Central Fidelity
Banks soared 18% on June
23, after North Carolina's
Wachovia agreed to buy the
Richmond-based bank.

The Midwest also looks
ripe for action. Analysts fa-
vor banks such as Mercan-
tile Bancorp of St. Louis,
which has been a successful

capital, are enjoying record
profitability, and have years
of experience at acquisitions.
But large commercial banks
are moving away from bank-
to-bank marriages. Taking ad-
vantage of the liberalization
of rules limiting the percent-
age of income a bank can get
from underwriting, they are

ult now, but consolidation keeps rolling along

The takeover titan has
e no secret of his desire
o more deals, and Kraw-
k thinks the stock, now
%, could rise 20% to 30%.
ut if you're really deter-
ed to prospect for take-

acquirer but could be the
right fit for a larger bank
seeking even more geo-
graphic mass. "Banking con-
solidation in the U.S. has
several years to go," says J.
Christopher Flowers, man-

now acquiring investment
companies, regional broker-
ages, and full-service firms to
round out the range of prod-
ucts they can offer retail and
corporate clients.

International banks are

of investment candidates.
As long as the overall mar-
ket and economy remain
healthy, it's likely that finan-
cial-services stocks will con-
tinue their ride for a while
longer.



AFTER THE HANDOVER, A 'GOLDEN OPPORTUNITY'?

Now that China has come marching into Hong Kong, is it time for investors to go marching out? It's certainly a temptation to take profits. After all, the blue-chip Hang Seng Index is

up 13% this year. Many "red chip" stocks—newer companies based in Hong Kong but controlled by Chinese state entities—have more than doubled. But most pros think the Hong Kong takeover will continue to pay big returns. "We view this as a golden opportunity," says Thomas R. Tuttle, co-manager of the big-cap Colonial Newport Tiger Fund.

At the same time, the face of the Hong Kong market is in for a change now that China has taken charge of the former British colony. As Chinese investors acquire stakes in some blue chips—and as rumors swirl that more moves

are in the offing—these pillars of the Hong Kong Establishment are undergoing a sea change. "The Chinese want to have major interests in strategic sectors of Hong Kong," says J. Mark Mobius, president of Templeton Emerging Markets Fund.

"These companies will look increasingly like Chinese companies."

And that, many pros say, is affecting the nature of Hong Kong investing. Analysts and fund managers now expect Hong Kong to take on

the characteristics of Asia's more volatile emerging markets, complete with less predictability in corporate earnings. "Following blue chips will become much more difficult," concedes Gary Greenberg, manager of Peregrine Asia Pacific Growth Fund.

While that's a reason to tread with caution, Greenberg and other pros remain bullish. After all, the main reason to plunge into developing economies is high growth. Bank of America expects China to grow 9.5% this year and 9% in 1998, against 6% for Hong Kong.

Despite these expectations, Tuttle notes the Hong Kong market is trading at 13.5 times forecast 1997 earnings, vs. the price-earnings ratios of 15 to 20 for many other emerging markets in Asia. In

TAKEOVER PLAY: Hang Seng Bank's stock has risen on rumors of a Chinese takeover.

fact, Tuttle thinks there's value in such blue chips. He points to estate developer Cheung Kong Holdings or HSBC. In Hong Kong, the global financial group that owns Hong Kong & Shanghai Bank. Like other Hong Kong blue chip companies offer American investors a way to put U.S. dollars (table). They have climbed recently, but many other blue chips have barely risen in 1997, except for the frenzy that accompanied the runup to Hong Kong's handover to Beijing.

BEIJING'S SIGHTS. While Hong Kong has been building for years, China's move into the financial chips intensified in 1997. China's state airline Air China Pacific, a conglomerate with ADR trades in the U.S., is under control of Cathay Pacific Airways, Hong Kong's premier carrier. Citic also purchased 20% of China Light & Heavy Industry, Hong Kong's premier utility.

Then, in May, British Telecom sold its stake in Hong Kong Telecom to state-owned China Telecom. Now, the street is abuzz with rumors that Hang Seng Bank, controlled by HSBC, is also in Beijing's sights.

Not every tale of Chinese buy-in has paid off. In the weeks before Beijing took its stake in Hong Kong Telecom, the phone company's price climbed 61%. The beneficiaries, however,

are out to be C&W, who gained access to the market and China Telecom will gain technical market know-how, perhaps a bigger piece of Hong Kong Telecom's road.

Since the deal, Hong Kong Telecom's stock has fallen 5%. But many Hong Kong investors think that's the exception. With Beijing at the helm, Hong Kong's blue chips are in for some big times. *Dave Lipton and Pete Engardio*

SMART MONEY

FINDING VALUE IN HONG KONG

COMPANY	DESCRIPTION	PRICE*	P-E RATIO**
CHEUNG KONG	Thriving property developer	\$9.81	9.2
HSBC	High-quality global bank	300.00	14.6
CATHAY PACIFIC	Hong Kong's airline	10.38	13.8
HONG KONG ELECTRIC	Big utility	3.97	13.6
CITIC PACIFIC	Chinese-owned conglomerate	6.30	20.3
HONG KONG TELECOM	Local Ma Bell	23.69	17.0

*Per American depositary receipt, July 1

**Estimated 1997 earnings

DATA: BANK OF NEW YORK, BLOOMBERG FINANCIAL MARKETS

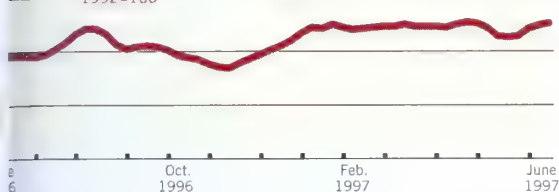
Business Week Index

PRODUCTION INDEX

Change from last week: 0.2%
Change from last year: 2.5%

PRODUCTION INDEX

June 21=122.5
1992=100



The production index continued to gain ground during the week ended June 21 for calculation of the four-week moving average, the index increased 0.2% from 122.1 in the previous week. On a seasonally adjusted basis, output of autos and trucks rose sharply, and increases were also reported in electric power and steel output. Crude oil refining, coal, and lumber production and rail-freight traffic declined.

Production index copyright 1997 by The McGraw-Hill Companies

PRICING INDICATORS

	LATEST WEEK	WEEK AGO	YEARLY % CHG
PRICES (6/27) S&P 500	887.30	898.70	32.3
RATE BOND YIELD, Aaa (6/27)	7.36%	7.33%	-3.9
PRICED MATERIALS PRICES (6/27)	106.2	105.9	0.0
TECHNICAL FAILURES (6/20)	NA	NA	NA
STATE LOANS (6/18) billions	NA	NA	NA
SUPPLY, M2 (6/16) billions	\$3,911.1	\$3,910.0	4.4
CLAIMS, UNEMPLOYMENT (6/21) thous.	332	346	-6.2

Sources: Standard & Poor's, Moody's, Journal of Commerce (index: 1990=100), Federal Reserve, Labor Dept.

BEST RATES

	LATEST WEEK	WEEK AGO	YEAR AGO
BANK FUNDS (7/1)	6.24%	5.39%	7.80%
COMMERCIAL PAPER (7/2) 3-month	5.64	5.63	5.50
CERTIFICATES OF DEPOSIT (7/2) 3-month	5.67	5.66	5.45
MORTGAGE (6/27) 30-year	7.81	7.81	8.49
FIXED RATE MORTGAGE (6/27) one-year	5.88	5.87	6.11
ADJUSTED RATE MORTGAGE (6/27)	8.50	8.50	8.25

Sources: Federal Reserve, HSH Associates, Bloomberg Financial Markets

Data in the production indicators are seasonally adjusted in computing the BW index (chart); other components (estimated and not listed) include machinery and defense equipment. 1=Western Wood Products Assn. 2=Southern Forest Products Assn. 3=Free market value NA=Not available r=revised NM=Not meaningful

THE WEEK AHEAD

INSTALLMENT CREDIT

July 8, 3 p.m. EDT ▶ Consumers added \$5 billion more in new installment debt than they paid off in May, according to a median forecast of economists surveyed by MMS International, one of The McGraw-Hill Companies. The expected gain was more than the \$7.6 billion added in May, and the \$7 billion monthly rate averaged in the first quarter. The borrowing surge is suggested by weak retail buying in the second quarter, especially for autos. Increases in debt in 1996 have led economists to suggest that many households are tapped out and will hold off borrowing more until their existing debts are paid down. However, steady job and

income gains suggest that consumers will resume spending at a more robust pace in the second half of 1997. If so, installment credit may well pick up again.

UNEMPLOYMENT CLAIMS

Thursday, July 10, 8:30 a.m. EDT ▶ New claims for state unemployment benefits probably amounted to about 300,000 for the week ended July 5. That number is quite below the rate of about 340,000 averaged in the four weeks ended June 21. But state-office closings for observance of Independence Day mean that benefits-seekers had one less day to file claims in early July. In March, claims had fallen to one of the lowest levels in this expansion. But

since then they have edged up, lifted by flooding in the Midwest and auto strikes.

PRODUCER PRICE INDEX

Friday, July 11, 8:30 a.m. EDT ▶ The MMS survey forecasts that producer prices of finished goods were unchanged in June, and that core prices, which exclude food and energy, rose just 0.1%. Continued declines in the wholesale cost of motor vehicles are expected to have offset price gains in other goods. In May, total producer prices and core prices each unexpectedly fell by 0.3%. This sign of a complete absence of inflationary pressures in the production process touched off big rallies in the financial markets.

PRODUCTION INDICATORS

	LATEST WEEK	WEEK AGO	YEARLY % CHG
STEEL (6/28) thous. of net tons	2,043	2,149#	2.9
AUTOS (6/28) units	114,618	133,415r#	-14.5
TRUCKS (6/28) units	121,088	130,007r#	8.2
ELECTRIC POWER (6/28) millions of kilowatt-hrs.	72,792	67,042#	2.9
CRUDE-OIL REFINING (6/28) thous. of bbl./day	14,988	15,052#	4.3
COAL (6/21) thous. of net tons	19,448#	20,428	0.4
LUMBER (6/21) millions of ft.	485.7#	516.3	2.9
RAIL FREIGHT (6/21) billions of ton-miles	26.1#	26.4	2.0

Sources: American Iron & Steel Institute, Ward's Automotive Reports, Edison Electric Institute, American Petroleum Institute, Energy Dept., WWPAl, SFPAl, Association of American Railroads

PRICES

	LATEST WEEK	WEEK AGO	YEARLY % CHG
GOLD (7/2) \$/troy oz.	332.200	338.450	-13.0
STEEL SCRAP (7/1) #1 heavy, \$/ton	138.50	138.50	0.0
COPPER (6/27) ¢/lb.	116.7	124.1	17.5
ALUMINUM (6/27) ¢/lb.	75.3	75.6	1.6
COTTON (6/28) strict low middling 1-1/16 in., ¢/lb.	72.19	71.15	-7.0
OIL (7/1) \$/bbl.	19.83	18.47	-6.9
CRB FOODSTUFFS (7/1) 1967=100	237.49	241.95	-14.5
CRB RAW INDUSTRIALS (7/1) 1967=100	335.36	335.36	1.0

Sources: London Wednesday final setting, Chicago market, Metals Week, Memphis market, NYMEX, Commodity Research Bureau

FOREIGN EXCHANGE

	LATEST WEEK	WEEK AGO	YEAR AGO
JAPANESE YEN (7/2)	114.41	114.03	110.13
GERMAN MARK (7/2)	1.75	1.73	1.53
BRITISH POUND (7/2)	1.67	1.66	1.56
FRENCH FRANC (7/2)	5.91	5.82	5.16
ITALIAN LIRA (7/2)	1705.8	1683.5	1535.5
CANADIAN DOLLAR (7/2)	1.38	1.39	1.36
MEXICAN PESO (7/2)	7.947	7.940	7.583
TRADE-WEIGHTED DOLLAR INDEX (7/2)	103.7	103.4	98.0

Sources: Major New York banks. Currencies expressed in units per U.S. dollar, except for British pound in dollars. Trade-weighted dollar via J.P. Morgan

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Index to Companies

This index gives the starting page for a story or feature with a significant reference to a company. Most subsidiaries are indexed under their own names. Companies listed only in tables are not included.

A

ABC (DIS) 22
ABN Amro 78
Aetna (AET) 78
Aetna U.S. Healthcare 57
Ahmanson (H.F.) (AHM) 54
Airbus Industrie 32
American Express (AXP) 78
Amertech (AIT) 25, 26
Apple Computer (AAPL) 34
Archer Daniels Midland (ADM) 27
Astoria Financial 78
AT&T (T) 25, 26, 64, 65
@Home 22, 24
Avon (AVP) 62
Award & Associates 57

B

Bankers Trust (BT) 52, 78
Bank of America (BAC) 54, 80
BankBoston (BKB) 55
Barnett Banks (BBI) 78
Bell & Howell (BHW) 62
BellSouth (BLS) 25
Bernstein (Sanford C.) 78
Boeing (BA) 32
Brean Murray 57
Bristol-Myers Squibb (BMY) 76
British Telecommunications (BTY) 65
Brown (Alex.) 62, 78
Burlington Industries (BUR) 44

C

Cable & Wireless (CWP) 65, 80
Cathay Pacific 80
Central Fidelity Banks (CFBS) 78
Chase Manhattan Bank (CMB) 62
Cheung Kong 80
China Light & Power 80
China Telecom 80
Citicorp (CCI) 78
Citic Pacific 80
Colonial Newport Tiger Fund 80
Columbia/HCA (COL) 34
Comcast (CMCSA) 22, 24
Commercial Credit 78
Compaq Computer (CPQ) 14, 64
Conference Board 19
Corel (COSFF) 14
Cox Communications (COX) 22, 24
Crabbe-Huson 62
Credit Suisse 52
Cyber Promotions 34

D

Dain Bosworth 54
Dalbar 56

Dean Witter (DWD) 55, 56

Dell Computer (DELL) 14
Deutsche Bank 52, 78
DFI International 32
Digital Equipment (DEC) 8, 64
Dillon Read 78
Donaldson Lufkin & Jenrette (DLJ) 78
DowElanco 6
Dreyfus 78
DuPont (DD) 11, 64

E

Electric Lightwave (ELI) 26
EMI 34
EMS-Chemie 36
Enron (ENE) 52
Envoy (ENVY) 57

F

FBR Financial Services Fund 78
Fidelity Investments 78
First Albany 57
First Chicago (FCN) 78
First Data 57
Florida Marlins 32
Ford (F) 30
Franklin Mutual Fund Advisors 62
Fuller (H.B.) 36

G

Gateway 2000 (GATE) 14
General Electric (GE) 78
General Motors (GM) 30, 34, 44, 52
Gerard Klauer Mattison 78
Great Western Financial (GWF) 54
GreenPoint Financial (GPT) 78
Gryphon Holdings (GRYP) 57
GTE (GTE) 25, 52, 65

H

Haggerty Enterprises 6
HBO 57
Healthcare Data Interchange 57
Hong Kong Telecom (HKT) 80
Hormel Foods (HRC) 34
HSBC Holdings 80

I

IBM (IBM) 64
Illinois Tool Works (ITW) 6
Inacom 64
Infinity Financial Technology 52
ING Barrings 78, 55
Institutional Venture Partners 24
Intel (INTC) 14, 34, 64

J

John Hancock Financial Industries Fund 78

John Hancock Regional Bank Fund 78

L

LCI International (LCI) 26
Legg Mason Wood Walker 25
Lehman Brothers (LEH) 30
Liggett Group 28
LJR Redbook Research 19
Lockheed Martin (LMT) 11, 67, 76
Los Angeles Dodgers 32
Lotus (IBM) 14

M

Massachusetts Financial Services 65
Matsushita 14
McDonnell Douglas (MCD) 32, 67
McGraw-Hill (MHP) 81
MCI (MCIC) 26, 64, 65
McLeod USA 25
Mellon Bank (MEL) 78
Mercantile Bancorp (MTL) 78
Meredith (MDP) 62
Merrill Lynch (MER) 30, 52, 56, 65
MFS Communications 65
Microsoft (MSFT) 14, 22, 24, 34, 62, 64
MMS International (MHP) 81
Montgomery Securities 55, 78
Morgan (J.P.) (JPM) 52, 78
Morgan Stanley Dean Witter 52, 62, 64
Motorola (MOT) 34

N

National Security Institute 76
NationsBank (NB) 54, 55, 78
NBC (GE) 22
NEC 14
Netscape Communications (NSCP) 22, 24
News Corp. (NWS) 32
Norwest (NOB) 18, 54

O

Office Depot (ODP) 34
Oppenheimer 78
Oracle (ORCL) 22
Owens-Corning (OWC) 76

P

PanelWebber (PWJ) 56
Peregrine Asia Pacific Growth Fund 80
Power Computing 34
PPG Industries (PPG) 76
Prudential Securities 25, 32, 56

Q

Qwest Communications 65

R

Raymond James Financial 57
Raytheon (RTN) 34
Regency Health Services (RHS) 57

Robinson-Humphreys
Rockwell International (RO)
Rogers Communications (RG) 22

Royal Dutch/Shell (R)
Ryder System (R) 4

S

SBC Communications (SBC) 25, 26
Schroder Wertheim
Scudder Stevens & Seward & Kissel 4
Shearson 78
Shields 62
Siemens 34
Smith Barney 56
Société Générale 58
Southern New England Telephone (SNG) 2
Sprint (FON) 26, 65
Standard & Poor's (SP)
Staples (SPLS) 34
Stora 11
Sumitomo 11
SunAmerica (SAI) 7
Sun Microsystems (SUN)
Swiss Bank 78

T

Tandem Computers (M)
Tele-Communications (TCOMA) 22, 24
Teleport Communications
Templeton Emerging Fund 80
Texas Instruments (TXI)

3M (MMM) 18
Time Warner (TWX)
Torchmark (TMK) 78
Townsend-Greenspan
Travelers Group (TRV)

UBS Securities 65
Unilever (UL) 11
U S West (USW) 22,
UUNET Technologies

Virtual Spin 26

U

Wachovia (WB) 78
Washington Mutual
WorldCom 65

V

Xerox (XRX) 52

Y

Yankee Group 25
Yuen Foong Paper 7

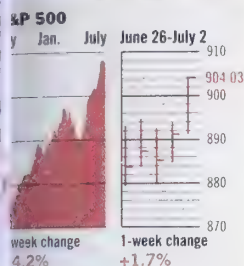
Z

Zeneca Ag Products
Zuercher Kantonalbank
Zurich Insurance 78

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Investment Figures of the Week

STOCKS



COMMENTARY

Stocks were skittish awaiting the Federal Reserve's decision about whether to raise interest rates. Fears of a hike were put to rest on July 2, when the Fed left rates unchanged. The Dow Jones industrial average reacted with a 3-point jump for joy, racing to 7795, one point below its all-time high. The 30-year Treasury yield was unchanged at 6.74%, and stock prices sunk to their low point in more than four years. Gold funds, as shown on this page, top the list of mutual-fund laggards.

U.S. MARKETS

	Latest	% change Week	Year
Dow Jones Industrials	7795.4	1.4	36.7
NASDAQ Combined Composite	1455.6	0.6	22.2
S&P MidCap 400	291.7	1.6	23.1
S&P SmallCap 600	161.9	1.9	20.2
S&P SuperComposite 1500	193.0	1.7	32.4

SECTORS

	Latest	% change Week	Year
Bloomberg Information Age	270.1	0.3	30.8
S&P Financials	103.8	1.6	52.8
S&P Utilities	200.7	2.5	-0.3
PSE Technology	289.8	1.1	38.8

FOREIGN MARKETS

	Latest	% change Week	Year
London (FT-SE 100)	4751.4	2.4	27.9
Frankfurt (DAX)	3854.8	1.5	50.1
Tokyo (NIKKEI 225)	20,196.4	-2.3	-9.8
Hong Kong (Hang Seng)	15,196.8	0.9	37.1
Toronto (TSE 300)	6549.0	0.5	29.4
Mexico City (IPC)	4559.2	3.7	42.5

FUNDAMENTALS

	Latest	Week ago	Year ago
S&P 500 Dividend Yield	1.82 %	1.66 %	2.13 %
S&P 500 P/E Ratio (Last 12 mos.)	22.6	22.8	19.4
S&P 500 P/E Ratio (Next 12 mos.)*	17.8	18.5	NA
First Call Earnings Surprise*	4.25 %	3.70 %	NA

TECHNICAL INDICATORS

	Latest	Week ago	Reading
S&P 500 200-day average	773.9	768.5	Positive
Stocks above 200-day average	78.0 %	78.0 %	Negative
Options: Put/call ratio	0.52	0.49	Negative
Insiders: Vickers Sell/buy ratio	1.91	1.81	Positive

Data: Bloomberg Financial Markets; *First Call Corp.

BEST-PERFORMING GROUPS

	Last month %	Last 12 months %
Trucking	20.1	Oil & Gas Drilling 79.0
Personal Loans	17.7	Savings & Loans 77.1
Drugs	16.4	Trucking 70.1
Drug Chains	16.3	Semiconductors 68.2
Oil & Gas Drilling	16.0	Invest. Banking/Bkrge. 64.9

WORST-PERFORMING GROUPS

	Last month %	Last 12 months %
Oil Exploration & Prod.	-8.2	Gold Mining -23.3
Gold Mining	-5.9	Engineering & Constr. -13.8
Photography/Imaging	-5.3	Electric Companies -3.3
Metal & Glass Containers	-4.5	Photography/Imaging -2.8
HMOs	-3.7	Manufactured Housing -2.4

BLOOMBERG MONEY FLOW ANALYSIS

Rebound ahead? Stocks with most significant buying on price weakness

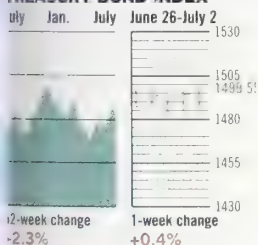
	Price	1-month change
Compaq Computer	101 7/8	-5 3/4
Oracle	48 9/16	-7/16
Amoco	88 7/8	-1/2
U.S. Robotics	81 1/32	-3 2/32
Micron Technology	40 3/8	-3 1/2
United Healthcare	52 1/4	-2 7/8

Decline ahead? Stocks with most significant selling on price strength

	Price	1-month change
Microsoft	124 15/16	9/16
Dell Computer	114 3/8	1
WorldCom	31 1/8	3
Nike	58	1 5/8
Philip Morris	43 7/8	1 1/8
Boeing	54 1/16	1 3/8

INTEREST RATES

TREASURY BOND INDEX



Bloomberg Financial Markets

KEY RATES

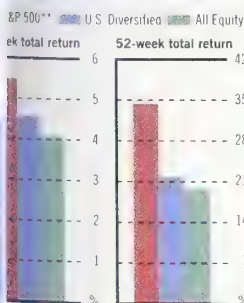
	Latest week %	Week ago %	Year ago %
MONEY MARKET FUNDS	5.17	5.15	4.93
90-DAY TREASURY BILLS	5.24	5.07	5.32
6-MONTH BANK CDS	5.19	5.19	4.99
1-YEAR TREASURY BILLS	5.63	5.67	5.80
10-YEAR TREASURY NOTES	6.44	6.45	6.80
30-YEAR TREASURY BONDS	6.74	6.74	6.94
LONG-TERM AA INDUSTRIALS	7.20	7.23	7.45
LONG-TERM BBB INDUSTRIALS	7.58	7.64	7.86
LONG-TERM AA TELEPHONES	7.46	7.47	7.74

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 31% federal tax rate.

	10-yr. bond Latest week	Last week	30-yr. bond Latest week	Last week
GENERAL OBLIGATIONS	4.77 %	4.75 %	5.34 %	5.32 %
PERCENT OF TREASURIES	74.49	73.76	79.62	79.00
TAXABLE EQUIVALENT	6.91	6.88	7.74	7.71
INSURED REVENUE BONDS	4.88	4.88	5.53	5.53
PERCENT OF TREASURIES	76.24	75.78	82.45	82.12
TAXABLE EQUIVALENT	7.07	7.07	8.01	8.01

MUTUAL FUNDS



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EQUITY FUNDS

Leaders	Four-week total return	%	Laggards	Four-week total return	%
American Heritage	23.5		United Svcs. Gold Shares	-14.7	
Lexington Troika Russia	12.4		Bull & Bear Gold Investors	-12.1	
Janus Olympus	10.2		Frontier Equity	-11.8	
Morgan Stan. Inst. Lat. Am. A	10.2		Midas	-11.6	
Wright EquiFd.-Mexico	10.0		Morgan Stan. Inst. Gold A	-10.8	
Leaders	52-week total return	%	Laggards	52-week total return	%
Morgan Stan. Inst. Lat. Am. A	61.9		United Svcs. Gold Shares	-46.8	
Morgan Stan. Latin Amer. A	59.7		Bull & Bear Gold Investors	-37.4	
Fidelity Select Home Finance	53.0		Morgan Stan. Inst. Gold A	-35.5	
Legg Mason Value Primary	52.2		Lexington Strategic Invmts.	-35.1	
American Heritage	52.2		Steadman Technology Grth.	-34.6	

EQUITY FUND CATEGORIES

Leaders	Four-week total return	%	Laggards	Four-week total return	%
Latin America	8.8		Precious Metals	-7.1	
Financial	6.4		Natural Resources	-0.5	
Communications	6.1		Japan	1.4	
Health	5.7		Diversified Pacific/Asia	1.7	
Large-cap Growth	5.6		Pacific/Asia ex-Japan	2.6	
Leaders	52-week total return	%	Laggards	52-week total return	%
Financial	44.0		Precious Metals	-24.4	
Latin America	41.5		Japan	-7.0	
Real Estate	33.1		Small-cap Growth	3.5	
Large-cap Blend	28.8		Diversified Pacific/Asia	5.0	
Large-cap Value	28.5		Pacific/Asia ex-Japan	9.7	

Data are as of market close Wednesday, July 2, 1997, unless otherwise indicated. Industry groups are S&P 500 companies only. Fundamentals, technical indicators, Bloomberg money flow analysis,

and mutual fund returns are as of July 1. For a more detailed explanation, write to us or e-mail figures@businessweek.com. NA=Not available **Vanguard Index 500 Fund

GREENSPAN'S BET ON THE NEW ECONOMY

Let us now praise Greenspan and bury Phillips. The Federal Reserve Chairman's lifelong odyssey in the dismal science has transformed him from an old-school conservative into a believer in the high-growth New Economy. Along the way, he has dealt a severe blow to the intellectual underpinnings of the Phillips Curve, which essentially sees an ironclad trade-off between economic growth and inflation. In challenging conventional wisdom, Greenspan is betting that America has more leeway to grow faster and generate more jobs, profits, and wealth without igniting inflation. It is not that the threat of inflation is dead. Far from it. It is simply that a radical change in the economy increases the speed limit beyond which prices accelerate. In this position Greenspan is nearly alone. Most of the Federal Open Market Committee, much of the economics profession (liberals and conservatives alike), and practically all of the bond-market vigilantes question his position.

They have been wrong. Seven years into a business-cycle upswing, with growth averaging nearly 4% for the past four quarters and 5% for the past two, inflation is actually falling. A short time ago, any dip in the unemployment rate below 6% would have set the monetary alarm bells off. Now, unemployment is at 4.8%, gold prices are swooning, commodity prices are off by 20% from their December peak, and consumer prices are up barely, at an annual rate of 1.9% on the experimental Bureau of Labor Statistics index. Even more amazing to Greenspan, corporate profit margins are holding up well even as real wages rise for the first time in decades. As long as profits continue to grow, they can sustain the current stock market boom.

Greenspan knows that the world can change. Higher productivity and intense global competition have nullified the va-

lidity of the Phillips Curve, which takes neither into account productivity nor global competition. Even though official statistics show only a 1% annual increase, Greenspan believes the U.S. may well be under a productivity surge not visible in the government figures. While global competition restrains companies from raising prices, productivity gains generate handsome profits just the same. In many industries, companies have to make money the old-fashioned way—by cutting costs and bringing out innovative products. In high tech, which now accounts for one-third of all economic growth, prices are actually falling as wages are climbing, and companies are still making profits thanks to productivity gains.

Greenspan didn't create the New Economy, but he deserves credit for recognizing its existence and accommodating its expansion through monetary policy. By understanding the new roles that productivity and global competition play, Greenspan is giving growth its head. He is allowing it to move faster than any of his colleagues at the Fed would have deemed safe.

Greenspan realizes this is all uncharted economic territory and remains ready to raise interest rates if growth surges unexpectedly. The big test may come as early as the second half of 1997 or early 1998. U.S., Asian, and European economic performance have all exceeded expectations in the first half of 1997. Greenspan thinks the U.S. economy will slow substantially from its torrid first-quarter rate, but if it doesn't, he's prepared to make a preemptive strike against inflation.

Neither Alan Greenspan nor any of us yet knows the precise parameters of the New Economy. But to his credit, the chairman is willing to take prudent risks to see how fast the economy can grow. So far, he has been dead-on.

THE TAX BILL IS GETTING OUT OF HAND

Confused about all the competing tax plans bouncing around Congress? So are we. The last time we looked, there were plans to cut the capital gains tax for top-bracket and low-bracket folks, index it for inflation or means-test it for fairness. There were proposals for child-tax credits that would go to the working poor and others that would favor the middle class. In the House and Senate bills, exemptions on inheritance taxes would jump to \$1 million for all estates; in President Clinton's proposal, only farmers and small-business people would benefit. Tobacco taxes would go up—or not. Airline ticket taxes definitely would rise. And education tax credits... Well, they're all over the place, with one bill favoring two-year colleges, another four-year schools, two bills pushing expanded IRAs for education, one not. This is shameful. Could we please end this mindless politicization of the tax code and return to the Reagan era Tax Reform Act of

1986? Can't we stop bribing taxpayers with their own money and get back to fundamentals?

The spirit of '86 is dead. Once again, the convoluted result of the political negotiations in Washington will be a bill that takes us further and further away from what should be the goal of tax reform: simplification and broadening of the tax base. We need to lower marginal rates, close loopholes, and stop giving tax breaks to every special interest in sight. Sadly, the current bill does little more than cut taxes and give breaks to powerful interest groups. It corrects constituencies. There is some conflict on which side should be on the receiving end, but the largesse still flows from politicians in Washington who determine who gets the money.

The country needs lower taxes, structured very simply and applied very widely. The goal should be to promote economic growth, wealth, and opportunity, not to reward political blocs or campaign contributors.

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Albert Einstein, Thomas Edison, and Alexander Graham Bell are shown in the background. The mailboxes are shown in the foreground.

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Nothing generates more power than partnership.

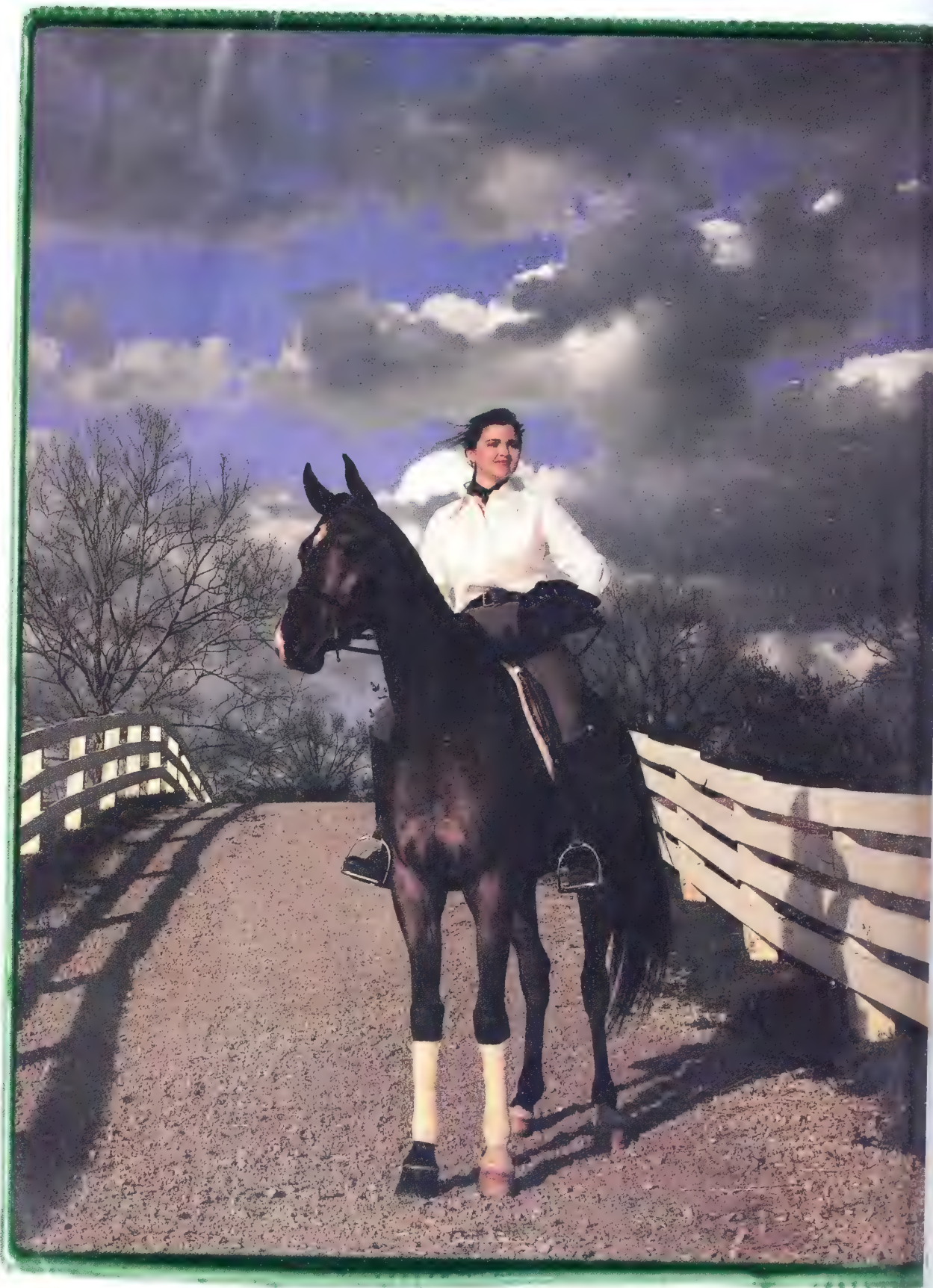


over a hundred years, energy
has been a relationship between
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and pipeline, and those who connected to it.
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and energy we'll bring you products and

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AFFORDABLE

FORMS OF TRANSPORT

In Georgetown, Kentucky, people will proudly tell you stories about their legendary thoroughbred horses. Champion racers, with familiar names like Citation, Whirlaway and Man o' War.

They might also brag a little about some other homegrown success

Toyota Motor Manufacturing



Kentucky, USA

stories. And rightfully so. Because the 400,000 Camrys and Avalons built every year by the people of Toyota Motor Manufacturing in Georgetown are winning hearts around America - and the world.

In every place where Toyotas are built - from Australia, to Thailand, to Kenya - the cars and trucks that are produced there reflect the pride of the people who build them. Because, not coincidentally, they are also the people who drive them.

Here in the U.S., Toyotas are being designed by Californians, tested in Arizona and Michigan, built in Kentucky, California, and soon in Indiana as well. In fact, more than half the Toyotas sold in America are built by Americans.

Toyota understands that growth in the global marketplace only comes when there is a deep understanding and respect of the unique qualities and needs of local operations and people. That's why, around the world, we invest in local design, local manufacturing, parts and jobs.

Sure it makes good business sense for Toyota. But it also makes for increased competitiveness and growth in the economies where we do business.

It's a win/win situation. And if there's one thing the people of Kentucky know - it's how to produce a winner.

TOYOTA People Drive Us

JULY 21, 1997

COVER STORY

SUCCESSFUL RETIREMENT

Workers now must cover more of the costs themselves. But there are fresh tools for the job *page 78*



Special Report

58 HOW TO RETIRE SUCCESSFULLY

These days, retirement involves more than collecting a watch and a pension. You've got to do plenty of planning. But with a robust economy and dozens of saving plans to choose from, you've got a good shot at truly golden years ahead

62 SECURING YOUR FUTURE

BUSINESS WEEK teams up with financial planners to create a self-help guide

70 AS YOUNG AS YOU FEEL

With adequate income and good health, there's no need to slow down

76 THE YOUNG AND THE THRIFTY

When GenXers start saving for their latter years, the payoff can be huge

78 PLANS FOR 'ALTERNATIVE' LIFESTYLES

Start early and consult with pros—the law provides few protections

84 THE SANDWICH GENERATION

One couple tries to lessen the financial bite of caring for other family members

85 RETIREMENT RIPOFFS

Small procedural errors have resulted in enormous losses

88 FOR THE GOOD LIFE, PRESS 'ENTER'

Software and Web sites can help you manage your retirement assets

92 COMMENTARY

Retired for 10 years, an ex-BUSINESS WEEK editor says so far, so good

News: Analysis & Commentary

28 LOCKHEED: A DEAL TOO FAR?

The Defense Dept., worried about the rush to consolidation, may have finally found a merger it doesn't like

30 JOHN GLENN, DONOR GATE PIT BULL

The colorless senator transforms into a fierce defender of the Democrats

31 COMMENTARY

Donorgate: Why the hearings won't provide the needed shakeup

32 WHAT'S NEXT FOR APPLE

Amelio exits, and Jobs will be playing a bigger role

33 COMMENTARY

Why SBC shouldn't be the first Bell in long distance

34 'THERE IS NO SILVER BULLET'

U.S. Trade Representative Charlene Barshefsky on U.S.-Japan trade

35 A TAX FLOOD FROM NOWHERE

Government revenues are soaring; most economists are confused

36 CRUISIN' FOR COMPUERVE

Technology LBO group Welsh Cable might be an interested buyer

38 CAR RACING WITHOUT THE SMOG

The checkered-flag set gears up unsponsored by tobacco

38 FOXWOODS ROLLS THE DICE

It bets on an expansion to fend casino rivals

40 IN BUSINESS THIS WEEK

International Business

42 JAPAN

Mob-linked investors extort billions from major companies. Will it ever change?

46 CHINA

The discreet charm of U.S. Ambassador Jim Sasser's connections in Washington

48 BRITAIN

Tony Sasser's secret weapon: Bill Clinton's experience

49 INTERNATIONAL OUTLOOK

Now Mexico's ruling party will come even faster



TY LENS
Optical revolution
offing? page 118

SOME JETS COME IN PIECES
Selling part interests in private
planes is a new way to soar page 52



MAZDA MAN
U.S. chief Beattie
faces a crowded
market page 98



BLACKMAIL!
How mobsters got
their hooks in Japan's
corporate giants page 42



**A COLD EYE ON
LOCKHEED**
The Pentagon
looks hard at the
latest defense
merger page 28



**WANTED:
NERDS**
Programmers
can write
their own
ticket page 110

Economic Analysis

OMIC VIEWPOINT

er: The new minimum wage

OMIC TRENDS

re business costs are hefty,
info revisited, the strong dollar's
ct on inflation

NESS OUTLOOK

ion's still lying low, but don't be
ised to see a second-half rebound

ple

SANTULLI'S SEMIPRIVATE JETS

utive Jet Aviation is booming, and
ing rivals, thanks to an innovation
d fractional ownership

ernment

FAA'S PROBABLE PILOT

Garvey is poised to take over the
led agency. Is she up to the task?

ial Issues

NDOW ON CORNING'S CULTURE

not quite the rigid company
ayed in a sociologist's study

The Corporation

98 STRUGGLING FOR MAZDA'S SOUL

Is the troubled Japanese carmaker
mapping its own American recovery
plan, or is Ford?

Finance

102 DIZZYING NEW WAYS TO DICE UP DEBT

The explosion in credit derivatives is
mostly a good thing

104 GOLD DOESN'T GLITTER

With inflation at bay, central banks are
selling—pounding investors

106 MONEY-LAUNDERERS, BEGONE

A new push puts banks on the front line

108 INSIDE WALL STREET

129 INVESTMENT FIGURES OF THE WEEK

Information Processing

18 TECHNOLOGY & YOU

Software for creating a family tree

110 THE GREAT PROGRAMMER DROUGHT

A critical shortage of software talent
has prompted a worldwide labor hunt

116 MASTECH SCOURS THE GLOBE

The company prospects in the Third
World for programming talent

Science & Technology

118 A LENS INTO THE FUTURE

LightPath's ray-bending optical feat

123 DEVELOPMENTS TO WATCH

Breast cancer test, virtual smells, heart
artery screener

Features

6 UP FRONT

10 EDITOR'S MEMO

12 READERS REPORT

12 CORRECTIONS & CLARIFICATIONS

14 BOOKS

Walton: *Car: A Drama of the American
Workplace*

15 BOOK BRIEF

127 BUSINESS WEEK INDEX

128 INDEX TO COMPANIES

130 EDITORIALS

Defense: The circle is getting tight
Don't sell the New Economy short

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Up Front

EDITED BY LARRY LIGHT

UNION BLUES

WHAT'S AILING STEVE YOKICH?

THE HOTTEST TOPIC IN DETROIT this summer is the health of United Auto Workers President Stephen Yokich. He underwent surgery for prostate cancer in late May, say several union and industry sources. But the nature of the operation was kept secret from many UAW officials, leading to rumors that Yokich had minor knee surgery or kidney stones.

An internal memo circulated later said that Yokich, 61, had undergone a "radical" surgical procedure. Speculation swirled again in late June, when Yokich reentered the hospital, causing the postponement of a June 27 meeting of Yokich, President Clinton, and the top Big Three auto execs. One source close



UAW CHIEF: Cancer surgery

to the union says Yokich was treated for an infection related to his surgery.

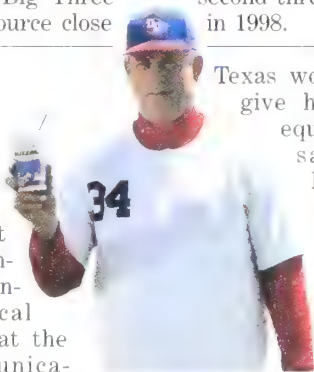
UAW officials did not return calls. "When you try to hide something, it makes people wonder more," says one source at the union. Health permitting, Yokich seems a shoo-in for reelection to a second three-year term, in 1998. *Bill Vlasic*

THE FEDS

FCC TO RYAN: 'YER OUT!'

IT'S O.K. TO BE A former pitcher but not a current pitcher if you're running for political office. That's what the Federal Communications Commission told Texas baseball legend Nolan Ryan, squelching his bid to become Texas' next agriculture commissioner.

Ryan, the all-time leader in Major League strikeouts before he retired in 1993 from the Texas Rangers, earns millions from commercials for Dairy Queen, Advil, and Wrangler. But when the FCC recently ruled this work amounts to free vote-for-me advertising, Ryan scrapped his plans to seek the GOP nod for commish. "Any station airing those commercials in



PITCHER but no pol

Texas would have to give his opponent equal airtime," says Mark Berlin, a senior attorney at the FCC—which, of course, none want to do. That's why, when Ronald Reagan ran for President, stations no longer showed his movies.

Ryan, 50, who declines to comment, had wide political support because of his experience as a rancher (he raises cattle on his 9,000 acres in Texas) and his down-home, aw-shucks appeal. He plays off that image in his ads promoting such products as the Dairy Queen Blizzard, a concoction made with ice cream and candy. Clearly, Ryan wants to keep living the sweet life. *Kate Murphy*

TALK SHOW "Our rover has nestled up and kissed Barnacle Bill."

—NASA's Matthew Golombek, on the first chemical testing of a rock on Mars

SLUGFESTS

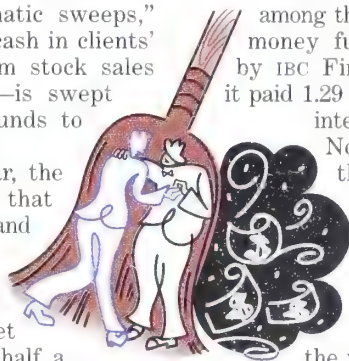
WHERE BROKERS PARK YOUR CASH

TWO WALL STREET FIRMS have sweetheart deals with money-market funds that work against the firms' clients, alleges a class action filed in Manhattan federal court. At issue: a common practice of broker-dealers called "automatic sweeps," where spare cash in clients' accounts—from stock sales or dividends—is swept into money funds to earn interest.

In particular, the suit charges that Bear Stearns and the Pershing Div. of Donaldson, Lufkin & Jenrette get payments (of half a percentage point or more of a sweep account) from Alliance Capital to shunt the cash into laggard Alliance funds. Says plaintiffs' attorney Stuart Wechsler, a partner in Wechsler Harwood Halebian & Feffer: "This is a kickback, plain and simple."

The suit claims that Bear and Pershing don't adequately

ly disclose what's going something that might prompt their clients to demand funds with better returns. Index Alliance Capital Research, which Wechsler paints as a typical Alliance fund, uses, ranks among the 476 tax-exempt money funds tracked by IBC Financial Data. It paid 1.29 points less interest than the No. 1 fund in the past 12 months. Bear Stearns and Pershing, who deny getting kickbacks, say the payments are



standard expense reimbursements to broker-dealers to bring in business. Moreover, Bear and Pershing clients receive a prospectus from a money funds disclosing its defendants say. Alliance Wechsler comment. If the suit survives a move to dismiss it, a court would mull certifying a class of alleged victims.

THE LIST TALK, TALK, TALK

Radio stations are switching to tighter formats. Talk radio is the big gainer, although its



LIMBAUGH: Big fat draw

growth is slowing. Its audiences like advice (such as from Dr. Laura) or commentary (Rush Limbaugh).

Meanwhile, baby boomers are getting more classic rock. But broader-ranging formats, such as adult contemporary, are losing ground among the 9,661 U.S. stations.

RADIO FORMATS: NET GAINERS AND LOSERS, 1991-1999

GAINERS	NO. STATION ADDED
NEWS/TALK	82
CLASSIC ROCK	29
COUNTRY	22
RELIGIOUS	21
SPANISH	11
LOSERS	NO. STATION DROPPED
ADULT CONTEMPORARY	51
TOP 40	40
EASY LISTENING	15
OLD STANDARDS	7
BUSINESS NEWS	4

DATA: VERONIS, SUHLER & ASSOCIATES



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Value ¹	5★	16.0%	20.7%	—	17.4% (9/1/93)
Income & Growth ¹	5★	19.7%	21.7%	16.4%	18.5% (12/17/90)
Average annual total returns as of 3/31/97. Morningstar Rankings as of 5/31/97. Funds rated for the overall period among 1,980 domestic stock funds.					



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BSW

HONCHOS

WILL THE SON RISE AT REVLON?

IS STEVEN PERELMAN BEING groomed to manage his dad's \$5 billion empire? At 54, swashbuckling financier Ron Perelman isn't going anywhere. But insiders are waiting to see if Ron's eldest child fixes a lagging unit of Revlon, which Pop controls.

Steve, 29, took over Revlon's fragrance division two years ago. Thus far, it hasn't matched the company's comeback in cosmetics. In 1996, Revlon had only one perfume in the top 10—Charlie (No. 9), amid an industry-wide slump. Yet in late August, Steve aims to launch a scent called She with a high-powered ad drive featuring actress Halle Berry.

All Ron has said about the future is that "I plan to leave



PERELMANS: Big test ahead

my assets to my children, so they should be interested in running them." He has six kids from three marriages, four of them in their 20s. Debbie, 24, also works at Revlon, as a management trainee. Hope and Joshua are in "public service" and in "business," says a privacy-minded Perelman spokesman. The other two are youngsters.

Since getting a joint law-business degree from Penn, Steve has been on Revlon's operational side while the old man cut deals. The much mellower Steve, who shares an occasional cigar with his hard-driving father, could wind up as the front-runner—if he can just get the smell of success right.

Leslie A. Brown

THE BIG PICTURE

RAGING BULLS

After a scare earlier in the year, the market is stoked, and so are the optimists. Almost two-thirds of those polled in early June, with the Dow poised to gain 600 points, were self-described bulls. Fearless, too:

42% call a 1,000-point drop a chance to buy cheaply.



DRAWN & QUARTERED



CREATURE COMFORTS

LODGING FOR THE SLEEP-CHALLENGED

ARE YOU ONE OF THOSE RED-EYED travelers who can't seem to get a good night's sleep in a strange hotel bed? Well, you're not alone. According to the National Sleep Foundation, up to 40% of travelers have some degree of insomnia. But help for road warriors who toss and turn is here.

Hilton Hotels recently started offering 25 Sleep-Tight rooms in five cities ranging from Washington to Beverly Hills. For the standard rate, those who ask can land a room far from ice machines and elevator shafts that is decked out with heavy drapes, a noise-muffling seal on the door, a circadian light to adjust to a new time zone, and even a gadget that emits such sooth-

ing sounds as waves breaking. New rooms at the Waldorf-Astoria in New York open July 18, featuring jacuzzi and a massaging

At Sheraton, Body Cuisine room service allows the time-zoned-out to order from a choice of 14 meals any time. Example: a ju steak at 8 a.m. when y



HILTON: Circadian light is a ho

body feels as if it's 8 p.m. At Hyatt has a Jet Lag Pack for \$40 that gives you all goods for a soothing lavender bath salts, body and a rubber duckie. Feeling sleepy yet? Leslie A. Brown

PRODUCT PEEK

THE NEXT IRRITATING FAD FROM JAPAN

FORGET TAMAGOTCHI pendants. Yet another Japanese craze is headed for U.S. youngsters—this one involving stickers with your offspring's mug pasted all over the place.

Don't be alarmed if the kid is pictured on a beach you've never been to or any one of 26 other unfamiliar scenes. For \$3, a Print Club kiosk takes the kid's picture

and dispenses 16 stamp-sized stickers on a sheet. Young Japanese (usually girls) collect and trade them to put on lockers, envelopes, Print Club sticker books, whatever.

The U.S. rollout aims to be big, with 10,000 machines

installed nationwide in fall. Parent company Atlus out to duplicate its success in Japan, where revenues have gone from zero to \$10 million in two years. Atlus wants arcades and stores to buy—not rent—the machines at \$10,000 each. But the kiosks are said to pay for themselves in just over a month.

Joshua Kaufman



FOOTNOTES Credit-card holders who always carry a balance: **35%**; who never do: **35%**

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We're proud to announce the premiere of a new series on public television: *This Week in Business*. The program is produced by WETA in Washington, D.C., in association with BUSINESS WEEK.

The half-hour program will appear in six U.S. cities beginning the weekend of July 18—New York (WNET), Boston (WGBH), Washington (WETA), Dallas (KDTN), Houston (KUHT), and Minneapolis/St. Paul (KTCI). For the time, check the TV listings in your local newspaper. A nationwide launch on PBS is planned for the winter of 1998.

WETA has a distinguished track record in public television. Its offerings include *The NewsHour with Jim Lehrer*, *Washington Week in Review*, and *In Performance at the White House*. BUSINESS WEEK brings the editorial resources and expertise of the world's best-selling business magazine, with more than 200 reporters and editors in New York and its network of news bureaus in 25 cities around the world.

This Week in Business, hosted by former ABC News Correspondent Sheilah Kast, is designed to make business news accessible to an audience that is less interested in up-to-the-minute stock market reports

than in the compelling stories unfolding in the business world.

Each week, Kast will lead a roundtable discussion of the week's most important business stories by the journalists who are covering them—from BUSINESS WEEK and other top publications. In addition, *This Week in Business* will include interviews with CEOs and other business newsmakers, to give viewers a closer understanding of the people who are creating news. "With *This Week in Business*' pool of experienced journalists, we will provide informed analysis of the most timely issues in the business arena," says David McGowan, a WETA senior vice-president.

Our goal at BUSINESS WEEK is to make the world of business as interesting and exciting as it is important. *This Week in Business* will provide a single place on television for the best reporting and analysis of the week's most compelling business stories. We are pleased to be taking a supporting role in this program—and we hope that you will be watching.

This Week in Business



Sheilah Kast

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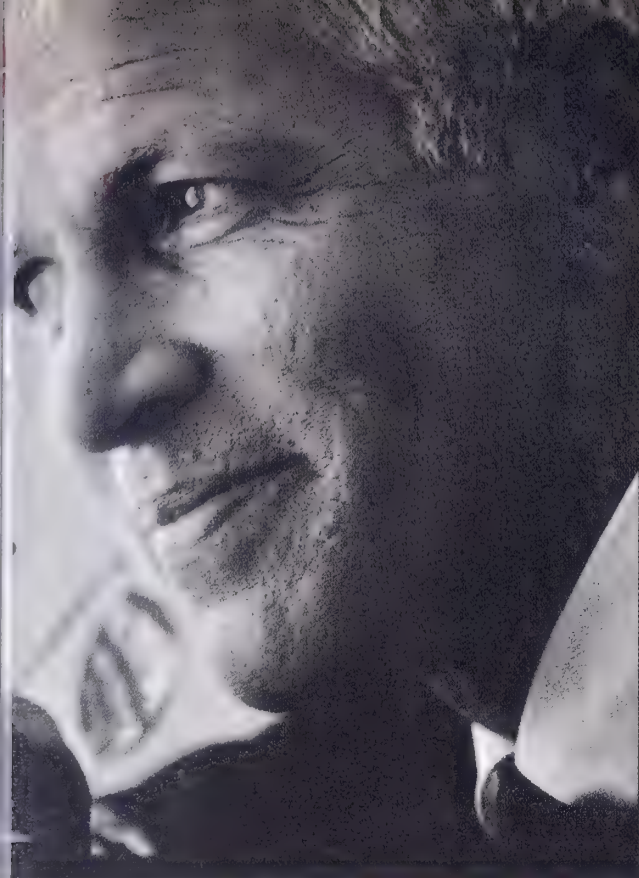
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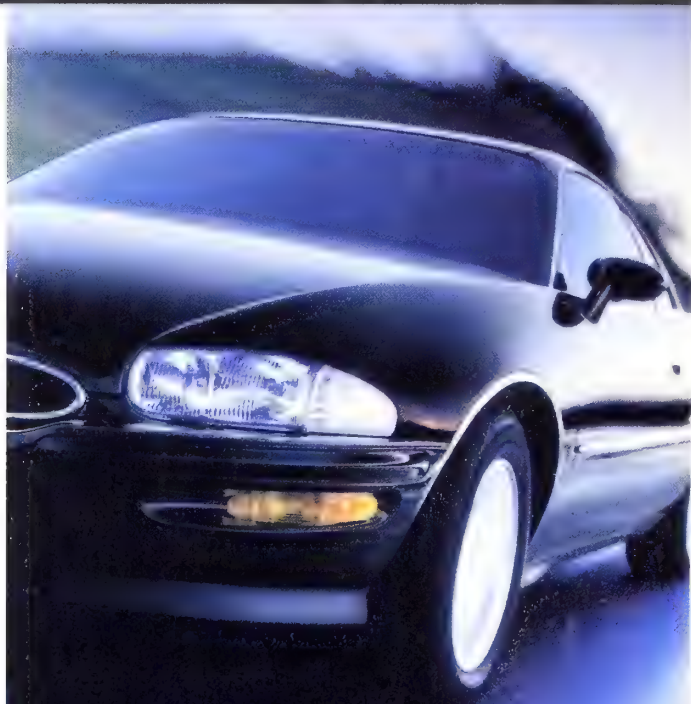
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Readers Report

MARKETING TO KIDS: WHO'S REALLY TO BLAME?

I finished "Hey kid, buy this!" (Cover Story, June 30) feeling hopeless and full of questions.

What kind of cultural void has given rise to our society's readiness to view our children as "the most pure consumers you could have"? If 200 years of

pester the mom to buy the product, rather than going straight to the mom."

And how have parents lost their role as gatekeepers? I guess we're too busy. We need two working parents with good incomes to provide our children with Chevy Venture minivans, McDonald's dinners, Calvin Klein jeans, Nike shoes, Nintendo 64 video games, and, don't forget, lots of Pepsi and Camel cigarettes.

Helen Van Ryzin
Waterford, Va.

When I read your article, I was way insulted. It made kids sound shallow, stupid, and like they don't have minds of their own to decide what to buy."

labels or because of commercials. Peer pressure is a big factor when we are about to buy clothes or even a drink. Next time you are going to write an article about kids, why don't you ask kids, not specialists.

Cristin Ann Costello (age 11)
Park City, Utah

CORRECTIONS & CLARIFICATIONS

"A company without a country" (News: Analysis & Commentary, May 5) incorrectly said Hongkong & Shanghai Banking Corp. moved to Britain in 1993. The bank remains in Hong Kong. It was the bank's parent company, HSBC Holdings PLC, that moved to Britain.

Congratulations—you've recognized a trend that has been a major shaper of both the marketplace and our society for the past 40 years.

Perhaps the most profound change of those that began in the '50s—the one that may ultimately be recognized as having had the greatest impact of all on our society—was a new way of looking at children. And it came out of television.

Prior to television, children were not seen as a market in their own right. Businesses providing goods and services to children sold these products to the parents rather than directly to the children. Television changed that. Very quickly, advertisers recognized that they could direct their messages at the chil-

BusinessWeek



NEXT TIME, ASK KIDS

"When I read your article, I was way insulted. It make kids sound shallow, stupid, and like they don't have minds of their own to decide what to buy."

a free-market economy has led us to this, I'm ready to consider socialism.

And what can intelligent, sensitive, caring parents do to avoid the bombardment of their children with this sophisticated marketing hype? And what about family values? We have advertising executives who "rely on the kid to

ThinkPad



Introducing the affordable new ThinkPad 380. The pow

en who would in turn sell the prod-
ts to their parents.

Arnold Brown
Chairman
Weiner, Edrich, Brown Inc.
New York

The consumer culture's invasion of
ldren's lives in and out of school sure-
deserves the exposé you gave it. One
sersion in the article, however, should
challenged: that "parents no longer
as filters between their kids and the

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world." On the contrary, this is precisely
ly what we are trying our hardest to do.

We need each other to succeed in
this effort, along with enlightened public
policy and improved (not necessarily
increased) corporate and nonprofit support.
Until our culture returns to a
more parent-friendly state, the best we
can do to resist the commercialization of
daily life is to buy simple toys, games,
and crafts for our children—and good
books—and, as often as we can, buy
logo-free, slogan-free clothes for our-
selves and our kids.

Eve Sullivan
Founder, Parents Forum Inc.
Cambridge, Mass.

Yes, I am one of those parents
"struggling to find kids underwear with-
out a licensing cartoon character on it."

Tom Kalinske, president of Knowl-
edge Universe, thinks "kids today are
more sophisticated than the generation
that preceded them" and that these
same kids are "able to recognize hype
and impervious to crude manipulations."
Many adults are unable to see through
deceptive advertising—as witnessed in
what we purchase for our children.

Right now, it's easy for me to fight
commercialism aimed at my children.
As a parent of a 3- and a 5-year-old, I
no longer go shopping at the mall on a

Saturday afternoon. All selecting and
purchasing for the children and the
household is done by one parent while
the other is home with the children.

Our preschoolers do not watch net-
work TV, Nickelodeon, or TNT. Our time
is spent at the museums, nature parks,
and historical sites learning about our-
selves instead of Mattel and Disney. I
am willing to bet that our close parental
supervision will have an impact.

Lynda T. Morley
Plano, Tex.

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CAR

A Drama of the American Workplace

By Mary Walton

Norton • 360pp • \$26.95

HOW FORD 'FIXED' THE TAURUS

For some reason, the anatomy of a flop is almost always more compelling than a sunny success story. Would Julie Salamon's 1991 Hollywood saga, *The Devil's Candy*, have been so fascinating if she hadn't been describing the disastrous film adaptation of Tom Wolfe's *The Bonfire of the Vanities*?

Still, when author Mary Walton set out in early 1993 to chronicle the development of the 1996 Taurus, it would have been hard to predict that America's top-selling car was heading for a fall, with a redesign whose styling was too radical and price tag too steep. Back then, Ford Motor Co. had high hopes that the Taurus' first major overhaul would result in another triumph. So then-Chairman Harold A. "Red" Poling agreed to give Walton, a former *Philadelphia Inquirer* reporter, a front-row seat in Ford's Design Center, amid the team of engineers, planners, designers, and marketers remaking The Car That Saved Ford.

The resulting book, *Car: A Drama of the American Workplace*, is a no-holds-barred account of how Ford fell far short of its lofty goals—and it's a good read to boot. Walton also provides an enlightening peek at the inner workings of a large corporation trying to reinvent itself.

The author was granted unprecedented access to the Taurus team, becoming a virtual insider at Ford for nearly three years. The company's only restriction was that Walton not publish proprietary details about costs and profits. Taurus program director Richard L. Landgraaf gave Walton entrée to team meetings and encouraged staffers to talk to her.

Apparently, Walton's tale was a bit too frank for Ford. When Ford managers saw a completed manuscript of the book to vet it for proprietary data,

the door slammed shut. (By then, it was already clear that Taurus sales were slumping.) Team members with whom Walton had chatted freely for years were instructed to refer her calls to the public-relations department. Ford, she writes, "came to regret having allowed a journalist such a candid look at its operations. No writer had been given such access before, I was told, and it would likely be a long time before it happened again."

It's not that Walton is unduly harsh. Indeed, she displays considerable sympathy for the ambitions and efforts of the engineers and managers whom she had come to know well. But she doesn't shy away from painful revelations, such as how America's No. 2 auto maker came to so seriously misgauge its customers.

In the most notable miscalculation, part way through the car's development, Landgraaf and his team drove a brand-new Toyota Camry, a fine, redesigned car that competed directly with the Taurus. Then and there, they decided that the Taurus had to match the Camry's engineering refinement and features. Since Toyota had put more cost into its sedan, so would Ford. What Ford didn't realize was that Toyota had already reversed course, slicing costs of its future models.

Walton's story follows the new Taurus from conception to assembly line to dealer lots, recounting many of the stumbles along the way. As in other books that have provided inside peeks at the birth of a new car, this account is replete with plucky engineers, visionary designers, the requisite close calls in winning approval for critical changes, and squabbles among team members. There are deft sketches of key charac-

ters, including team leader Landgraaf, blunt, antisocial man who tends to expect the worst of his fellow humans, and chief engineer George Bell, a car manager who says he feels bad all the time if he has to chew out a subordinate.

But unlike most auto tomes, Walton doesn't leave the reader with the impression that cars are actually built by the guys in wingtips. Her story encompasses the workers in Chicago and Atlanta who assemble the Taurus. Even more unusual, she reaches out to include supplier employees, chronicling a day in the life of Ed Ramirez Alarcon, a Mexican-born resident who sews seat covers for Ford supplier.

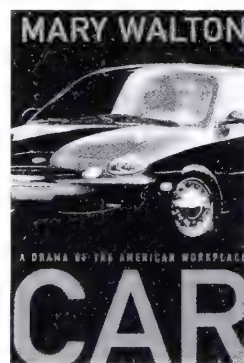
The fly-on-the-wall approach yields fascinating insights into Ford's struggles to adapt its militaristic command-and-control management style to the new era of team decision-making. The team wrestled for months with the question of where the Taurus' side-view mirror should be placed. Walton then presented their recommendation to Ford's head of North American auto operations, Alexander J. Trotter, who is now chairman. Trotter's boss listened, then vetoed their choice.

Walton's account of the Taurus' gestation will be incomprehensible to readers who don't know a bush from a gimp. Auto insiders may find her explanation unnecessary, but neophytes will appreciate the asides that, when needed, explain the different ways a door can be mounted on a car, for example. Walton does ramble at times, and lengthy sections describing skirmishing between Ford's PR staff and Detroit's scribes (including this reviewer, who was the 1995 *BUSINESS WEEK* Cover Story) may be compelling.

Still, it's rare to find an auto book that explains the process of creating a car with so much color and detail. Walton provides an unusual glimpse into how a big corporation filled with smart, capable, and well-intentioned people can go so far short of its goals.

BY KATHLEEN KERWIN

Kerwin is *BUSINESS WEEK*'s Detroit bureau chief.



FORD, WALTON WRITES, "CAME TO REGRET HAVING ALLOWED A JOURNALIST SUCH A CANDID LOOK"

BRIEFS

de Story of Hollywood's Most
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TZ RANTING

n months after his unceremoni-
resignation as Walt Disney Co.'s
ent, Michael Ovitz remains nearly
gnomatic as he was during his 20-
limb to become Hollywood's pre-
it talent agent. There are, how-
some snippets of Ovitz honesty
ome through in *Ovitz*, Robert
s account of his rise and fall. What
wrong between Ovitz and Disney
an Michael Eisner? "We were go-
be partners. We were going to
e company together... But it did-
ck from the day I started."
of his controversial \$125 million
nce package for 14 months of
"I just made a smart deal for my-
This is America. This isn't the
Union. It's the supply-and-
d of the marketplace."

For 55 pages, *Ovitz* is fairly littered with the sound and fury of a man seeking vindication, and it can be eye-opening stuff. But the problem with Slater's tome is that it runs 360 pages. And most of the rest of it, while mind-numbing in its detail, never really gets to the man who is Michael Ovitz, the super-agent who loved the deal but rarely had to live with the consequences—until his own future was at stake.

Do we really need to know of young Michael's exploits as a baseball player or high school gymnast? Or that it was his father, David, who offered encouragement for his son to leave the William Morris Agency to start the soon-to-be-powerful Creative Artists Agency? Ovitz' rise to power is chronicled with many of the anecdotes that already dot Ovitz press accounts, from his ritualistic lobbying of literary agent Mort Janklow to his deals for Sony and Matsushita that allowed them to buy their way into Hollywood.

Slater, a onetime United Press International reporter who has penned largely positive books on superinvestor

George Soros and General Electric Co, Chairman Jack Welch, writes openly of his efforts to win Ovitz' help with the book and his ultimate respect for the dealmaker. Like dozens of others, Slater was no doubt mesmerized by Ovitz' charm. Indeed, Ovitz opened his Rolodex for Slater, facilitating interviews with the glitterati of Hollywood, from Sean Connery to basketball's Magic Johnson. Still, not many reporters would succumb to the level of flattery often found here.

Slater, who negotiated Ovitz' help just after the agent joined Disney, was seemingly en route to writing the inside tale of a mogul on the rise. Clearly, that changed when Ovitz met his Disney demise, forcing Slater to rush in order to cash in on the publicity. This speed-up shows, as when Slater mistakenly calls Disney board member Gary L. Wilson "Donald" or when he says Eisner came to Disney in 1985 instead of 1984. But these mistakes are a small price to pay for unbridled Michael Ovitz—at least for 55 quote-packed pages.

BY RONALD GROVER



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to make sure
he won't be
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Randy and Joan Hansen were a little concerned about Alex's future. After all, their incomes while certainly respectable, didn't exactly reach Ivy League proportions. So they called Dave, their American Express financial advisor. He took a look at the Hansen's current financial situation and came up with a number of investment options — many of which they'd never considered before. Then together, they decided on a plan that was a nice balance of aspiration and practicality. Thus began a financial journey that will last the next fifteen years. And give Alex the education he needs to get him wherever he wants to go. As long as it's eventually out on his own.

<http://www.americanexpress.com/advisors>



**Financial
Advisors**

BY STEPHEN H. WILDSTROM

TRACING YOUR ROOTS VIA PC

Broderbund's software helps you create a family tree and search for data

Millions of people are still asking that all-too-familiar question: "Why do I need a home computer?" While kids take naturally to computers, for many adults they remain little more than glorified—and expensive—typewriters. But if you're fascinated with history and have a yen to better understand your family's past, there may now be a compelling reason to take the PC plunge.

Family Tree Maker 4.0 from Broderbund Software Inc. (510 794-6850) takes advantage of three things computers are truly good at: formatting and printing complex documents such as family trees, organizing tangled information into a coherent database such as a family history, and searching public data sources. And while it has competitors, most notably Corel's \$79 *Family Tree Suite*, the Broderbund product seems the most comprehensive.

KINSHIP REPORT. The \$60 basic version of *Family Tree Maker* is a sort of specialized information manager and word processor. (So far, it's available only for Windows—Macintosh users will have to settle for an older version.) You start a new tree with a "family page" on which you

enter information about yourself, your spouse (or spouses), and any children. The page is part of an on-screen notebook, and as you add data, new pages are created for your parents and your spouse's parents.

You can enter as much or as little information about each individual as you want. You can go from the basics, such as dates and places of birth and death, to details of military records or medical histories. Any information you lack can simply be left blank.

Once the data are entered,



you can use them to print a variety of reports. Starting with any individual, you can build family trees of either descendants or ancestors. And since *Family Tree Maker* understands relationships, it can generate a kinship report that tells how each person in your family is related to any given individual. It also lets you combine these reports with scanned pictures or documents into a printed

family album. Think of the holiday gift possibilities!

Of course, unless you come from a family that keeps scrupulous records, you're probably going to run out of information on your ancestors within a couple of generations. That's where the program's research capabilities come in. Vast computerized databases of genealogical information exist, and Broderbund gives you an easy way to tap them.

READY-MADE LIMB. The \$110 deluxe edition of *Family Tree Maker* includes seven CD-ROMs of data, including two that contain 50 years' worth of Social Security death records. The other five hold thousands of family histories that have been submitted to Broderbund by users of *Family Tree Maker*. If you discover relatives while searching this database, you may be able to add a ready-made limb to your family tree. The software makes it easy to import data from these databases into your own records.

Broderbund also offers a variety of other information sources, including census records for 1790 to 1920; state vital-statistics files, such as births and marriages; and military and immigration records. In most cases, you can order either the additional CD for around \$30 or pay Broderbund's partner, Genealogy Research Associates, \$8 per search. Either can be done from Broderbund's Web site, www.familytreemaker.com.

I haven't had much luck yet in tracking down my scattered (and mostly European) ancestors, nor have I yet found a family tree in the database that intersects mine. But the process is fascinating, and I'm going to keep trying.

BULLETIN BOARD

PRINTERS

PHOTO QUALITY

If you want the simplest, quickest way to get photo-quality output from your computer, the \$450 TruPhoto printer from Panasonic (800 726-2746) may be a good choice. The TruPhoto uses heat to develop dyes



embedded in its special shot-size paper (\$14.95 for 10 sheets) and spits out a print in about two minutes. Unlike inkjets, the TruPhoto prints emerge dry and won't smudge. The printer, which works with Windows or Macintosh, comes bundled with MGI PhotoSuite image-editing software. You may want to use the program to tweak the colors a bit, as I found TruPhoto prints consistently too blue.

SWITCHES

LINKING UP

The CompuSwitch from Rantan Computer (908 874-4444) isn't the sort of thing everyone can use, but if you need it, you need it badly. It's a book-size, \$595 box that you control up to four PCs with a single monitor, keyboard, and mouse. Pushbuttons let you switch among up to four computers. The compact CompuSwitch may be particularly useful for small businesses or groups of workers that want a dedicated network file server but don't want to waste space on a separate monitor and keyboard.

QUESTIONS? COMMENTS? E-mail tech&you@businessweek.com or fax (202) 383-2125

ROBERT KUTTNER

D MUCH FOR THE MINIMUM-WAGE SCARE



UPRISE:
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When Congress debated the minimum wage hike in 1996, critics warned that it would cost jobs, especially among the low-skilled. In theory, the free market was already paying what low-wage workers were worth. Raise the wage, and you price workers above the value they can add. An excessive price for labor yields a reduced quantity of jobs.

Well, the minimum wage was raised from \$4.25 to \$4.75 last Oct. 1; it will increase again, to \$5.15, on Sept. 1. But the unemployment rate keeps dropping. A study by the Economic Policy Institute (EPI) finds no job losses. If anything, there is a slight job increase, even among teenagers and young adults, who would be the most likely to be displaced. The EPI also finds great economic benefits for the working poor. Prior to the minimum wage hike, 50.6% of working teenagers earned less than the new minimum of \$5.15. All will now receive higher rewards for their labor. The two-thirds of minimum-wage workers who are adults will also benefit.

But isn't this just a case of lucky timing? Surely, unemployment is down because the economy is booming. In theory, the economy might have created even more jobs if employers didn't have to pay excess wages to the low-skilled. As we shall see, however, the theory fails.

UNDERDOG. This debate, of course, is ideological as well as empirical. Conservatives believe the market naturally prices things appropriately; they dislike regulation. Liberals believe market forces sometimes price things wrong and often take unfair advantage of the underdog; regulation can sometimes yield better and fairer rates. On the minimum wage, the empirical question is whether greater rewards to low-wage workers are in fact offset by higher unemployment.

As Congress debated the minimum wage, a parallel debate raged among academic economists. Princeton University labor economists David Card and Alan Krueger, in their 1995 book *Myth & Measurement*, collected data comparing employment effects of a state minimum wage increase in New Jersey with employment trends across the river in Pennsylvania, where no comparable hike had been legislated. They found that higher wages in New Jersey did not produce higher unemployment. Evidently, the new wages reduced turnover expenses (recruiting and training),

and employers could also squeeze productivity gains out of the now higher-paid, better-motivated, and more stable workforce. These benefits offset the higher costs. The Card-Krueger research was widely cited by proponents of the 1996 minimum-wage hike.

Opponents of the minimum wage pointed to a study by a rival group of labor economists, Donald Deere and Finis Welch of Texas A&M University and Kevin M. Murphy of the University of Chicago. Their study examined the last minimum-wage hike, in 1990-91. They calculated that the earlier increase, from \$3.35 to \$4.25, resulted in job losses among all the demographic groups they studied, with pronounced negative effects among school dropouts, teenagers, minorities, and young workers generally.

VOLATILE. However, critics observed that 1990-91 was a recession, and faulted Deere et al. for confusing the effects of the business cycle with the impact of a higher minimum wage. The study had attempted to correct for this effect by using changes in employment rates for prime-age males as a proxy for business-cycle effects. But this particular variable likely understated the impact of the recession, since teen and minority employment is much more volatile and vulnerable to general downturns.

Now EPI economists have applied the same Deere-Welch-Murphy model to the latest hike, which occurred during a boom. The model that showed a higher minimum wage costing jobs in 1990-91 now shows the minimum-wage hike increasing employment—among teenagers, minorities, and dropouts. (The study, *The Sky Hasn't Fallen*, by Jared Bernstein and John Schmitt, is available from the EPI. Disclosure: I serve on the EPI's board.)

This research strongly suggests that Deere et al. were mistakenly attributing recession job losses to the minimum wage—and that economic booms can compensate for any slight negative effects of a minimum-wage hike (Alan Greenspan, take note). A \$15 minimum wage might indeed be both inflationary and destructive of jobs. But a modestly higher minimum wage creates real economic benefits for the working poor without harming the larger economy.

A society with a work ethic needs jobs that pay a living wage. Sensible minimum wage laws and a Fed willing to tolerate growth can both help.

Time Saving Technology Tips for Busy Executive

Third in a Series Sponsored by AT&T

A WORLD WITHIN REACH

Tom Ku epitomizes the new breed of business executive—a trader in intellectual capital who must be “at home” wherever his work takes him. He divides his time between his company’s Sunnyvale, Calif., and Liberty Corner, N.J., offices, but spends nearly one-third of his time on the road, often in Europe and Asia. Yet for all of his travels, he’s never out of reach.

Tom Ku is vice-president, professional services for BEA Systems, Inc., the world’s top seller of “enterprise middleware,” a sophisticated type of software that allows different kinds of computers to talk to one another. It’s a challenge similar to what Mr. Ku faces on the road: getting different national phone systems to talk to one another so that he can stay in touch with clients, colleagues, and his home office.

HIS ANSWER: AT&T’s International Business Traveler Solutions. A lifelong AT&T user—because of the company’s dependability and worldwide availability—Mr. Ku has insisted on AT&T long distance service in every executive post he’s held. Now that he spends so much time outside the country, he’s reaping the rewards of that decision.

“AT&T’s international services are a real lifesaver,” he says. “With AT&T, you can have telephone service just like in the United States—no matter what country you’re in.”

THAT WAS PRECISELY AT&T’s goal when the company originated its new International Business Traveler Solutions. A recent AT&T white paper entitled “Technology That Travels” explains: “Even though the world of the ‘90s is synonymous with being wired, connected, and instantly in touch... the weary business traveler sees a very different world. The jet-lagged executive in a hotel room in Frankfurt or Singapore who misdials a phone call gets a very helpful message—in a language he doesn’t understand. Or, has problems

with number pads that do not have letters—or encounters dial tones that sound like busy signals.”



To avoid these problems, Mr. Ku, like millions of other business travelers, dials directly into AT&T. When he has to use an operator, Mr. Ku invariably turns to AT&T Direct[®] Service, because he knows he’ll always find a knowledgeable, courteous, and English-speaking attendant on the other end. “I can reach AT&T faster than I can a local operator,” he says.

ONE OF THE FIRST THINGS he does when he alights at an airport or hotel is to hook up his computer to phone lines so that he can check his e-mail and log on

to his company’s intranet. With AT&T’s international remote access service and free laptop access software, he never has to worry about making a secure and reliable connection.

But AT&T’s most useful service, he explains, is the AT&T Corporate Calling Card, which, with AT&T Direct Service lets you call to and from telephones in more than 200 countries around the world. Long ago having devoted his card number to memory, he finds it far more convenient than coins or conventional credit card phones—which never seem to be available when he needs them.

PLUS, WITH THE AT&T CARD, he can be on the phone with clients and colleagues within minutes after touching down. On a recent trip to Munich, which has some of the most forbidding pay phones in the world, Mr. Ku bet his disbelieving boss a dollar that he could be online with the home office in less than a minute. Thanks to AT&T, Mr. Ku won the bet. But he’s still waiting for that dollar.

Mr. Ku originally got hooked on AT&T when, as a college student, his father gave him an AT&T calling card. Now, he’s passing on the AT&T legacy to a new generation, insisting that all of the 70 employees in his division use AT&T services whenever they’re on the road. Not only does this consolidate phone charges into one easily manageable bill, but it has cut the average traveler’s \$400 phone bill nearly in half.

When Tom Ku first started in the computer business, he dreamed of making multi-million deals the world over. Now, with AT&T’s International Business Traveler Solutions, he has found that this goal is “all within his reach.”

Kosim R. Hopkirk, who heads a San Diego-based corporate communications company, writes frequently about technology and telecommunications.



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BY GENE KORETZ

NOT ALL STATES ARE EQUAL...

Especially in their business costs

In the current expansion, some states have logged rapid growth, while others have lagged behind. While many factors affect a state's short-run gains, the cost of doing business can clearly impede its long-run economic performance.

How do individual states stack up? An annual business-cost index developed by Regional Financial Associates Inc. (RFA), based on labor costs, taxes, and energy costs, indicates that the priciest by a hefty margin is Hawaii, followed by California and several New England and Mid-Atlantic states (table). With the nation's highest energy and unit labor costs and the second-highest taxes, Hawaii also has had the weakest state economy for years.

On the tax front, New York imposes the heaviest burden, with state and local levies 33% above the national average. (Other high taxers include Michigan, Minnesota, Washington, and Wisconsin as well as Hawaii.) But taxes account for only 10% of RFA's state business cost index. Some 75% reflects unit labor costs (compensation per unit of output),

WHERE DOING BUSINESS IS PRICEY—AND NOT

HIGH-COST STATES		LOW-COST STATES	
PERCENT OF NATIONAL AVERAGE		PERCENT OF NATIONAL AVERAGE	
HAWAII	123.1	WYOMING	86.5
CONNECTICUT	116.8	KENTUCKY	87.0
NEW JERSEY	115.0	LOUISIANA	89.7
MASS.	112.9	MISSISSIPPI	91.3
NEW YORK	110.7	OKLAHOMA	92.2
CALIFORNIA	110.0	ALABAMA	92.6
MAINE	110.0	SOUTH DAKOTA	93.1
NEW HAMPSHIRE	109.1	IDAHO	94.0

DATA: REGIONAL FINANCIAL ASSOCIATES, INC.

and New York is 17th in that category, with costs only 2% above average—compared with 9% to 12% for Illinois, New Jersey, Connecticut, and Hawaii, the cost leaders.

Recently, the largest changes in state rankings have been caused by shifting energy costs, which account for 15% of the RFA index. Hawaii's costs are now 75% above the national average, and several New England states have also

been hit with double-digit increases in energy prices. Meanwhile, several states with low business costs, such as Kentucky, Missouri, New Mexico, and Tennessee, have reaped the added benefit of declines in electricity rates.

The good news for several high-business-cost states, such as California, Illinois, Massachusetts, and New York, says RFA economist Patrick J. Howie, is that they may soon get some relief from the sky-high energy costs that have plagued them for years. "Ongoing deregulation of the electric utility industry promises to give a big boost to their competitiveness," he predicts.

UH-OH, WARM WATER

El Niño may be back this year

Exploding grain and food prices, sagging oil prices, devastating drought conditions in Australia, southern Africa, and Argentina, coupled with floods and excessive wet weather in other regions. It's happened before, and it could happen again over the next year or two, thanks to a culprit known as El Niño.

El Niño ("the little one") is the name given to a sharp warming of ocean currents off the Pacific coast of South America. According to meteorologists, this phenomenon, which caused severe weather disruptions around the world in the early 1970s and early 1980s, appears to be occurring again this year.

The 1970s episode was associated with a sharp rise in food inflation. After it decimated Peru's anchovy catch, a prime source of protein for animal feed, prices of meat and soybean meal skyrocketed. And poor harvests in the Soviet Union and southern Asia led to an explosion in grain prices.

When El Niño returned in the 1980s, Australia, Africa, and Indonesia experienced extreme droughts, dust storms, and brush fires, while Peru and Chile suffered torrential rain. Drought conditions affected the U.S., and eastern states had their warmest winter in 25 years, curbing heating oil demand.

If a strong El Niño is reappearing this year, says economist L. Douglas Lee of HSBC Washington Analysis, it's likely to cause disruptive weather patterns that will hurt harvests and push up food prices—particularly since worldwide grain stocks are unusually low. "Though, by itself, that doesn't portend big problems for the U.S. economy," he says, "it's something to keep an eye on."

STRONG DOLLAR, LOW PRICES

Cheap imports help cool inflation

Rising productivity and worker anxiety undoubtedly played a part in the slowdown of inflation that has allowed the Federal Reserve to step on the monetary brakes at past two meetings. But a more crucial factor, contend several economists, has been the strong dollar's impact on import prices.

In the 22 months since July, notes economic consultant A. Gary Brinner, as the dollar rose 17%, nonoil import prices fell 3.6%. By contrast, during the prior 22 months, a period of dollar weakness, they rose a hefty 7%. "If nonoil import prices had continued to increase at the latter pace," he says, "the Fed would have faced a year-over-year rise in producer prices about two percentage points higher than the negligible increases recently reported."

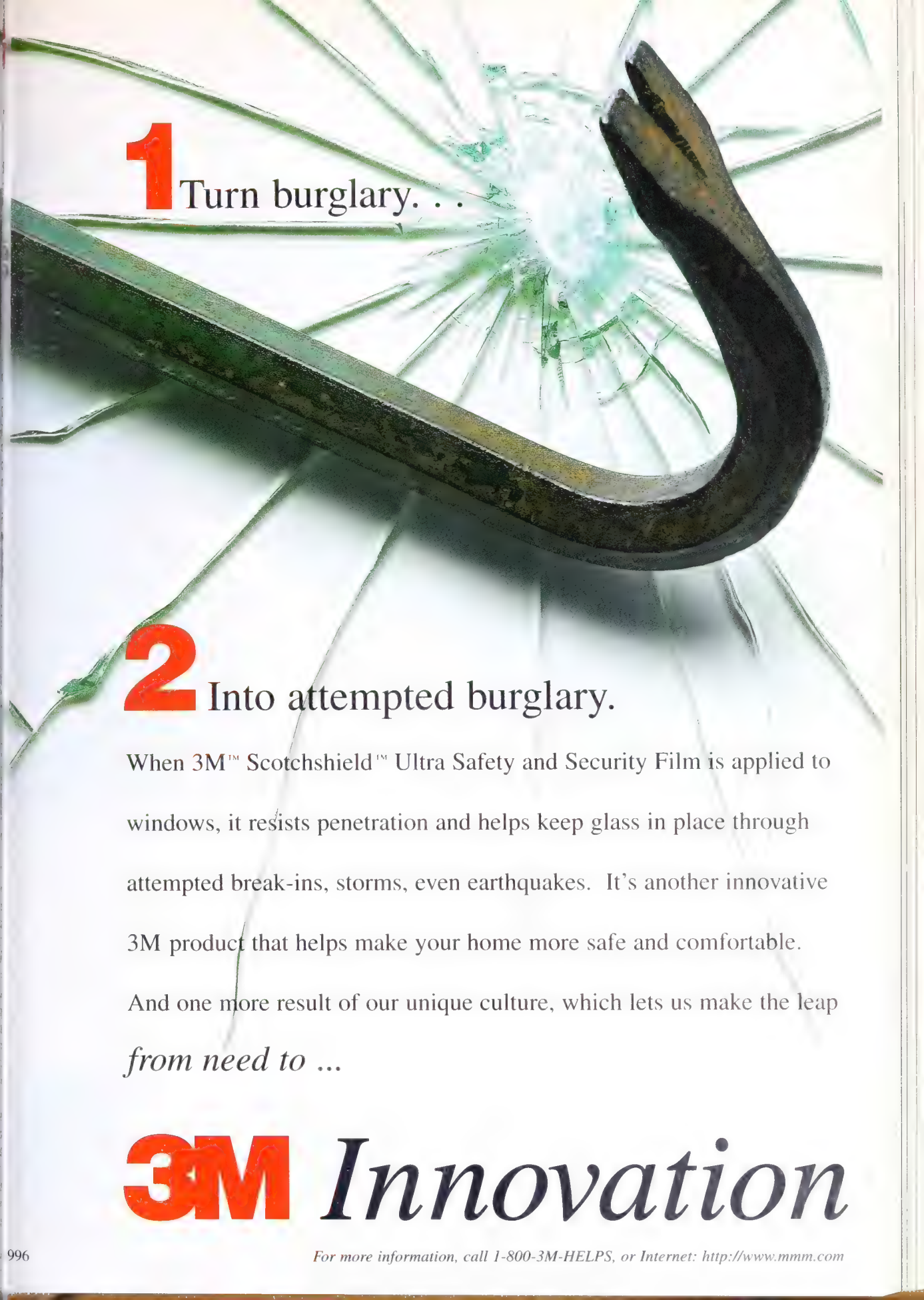
Similarly, Roger Brinner of DRI/McGraw-Hill calculates that the dollar's rise from mid-1995 through last quarter has reduced the current pace of overall inflation by as much as a full percentage point, reflecting both the drop in nonoil import prices and its competitive impact on domestic producers. At the same time, DRI estimates that the low level of unemployment last year added only a third of a percentage point to recent inflation via higher wage growth.

Thus, the downward push of the strong dollar on prices more than offsets the impact of low unemployment, resulting in the deceleration of inflation that allowed the Fed to forgo rate hikes. What's more, both Shilling and Brinner believe that the dollar could strengthen even more in the months ahead—providing continued relief from wage pressures.

Of course, this scenario involves as well as benefits. At some point, warns Brinner, the exploding U.S. trade deficit—or an unexpectedly robust global upturn—could undermine the Fed's unleashing inflationary pressures, which would sharply amplify rather than dampen the impact of rising wages.

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HOW LONG WILL INFLATION HAWKS BE GROUNDED?

With jobs still growing, consumers could raise price fears again

U.S. ECONOMY

Inflation hawks are becoming an endangered species. When they start to circle, they get shot down by another load of inflationless economic data. The latest load of hot was fired by the June employment report. It showed slower-than-expected growth in payrolls, a rise in the unemployment rate, and an actual slowdown in growth.

When the feathers went flying, Wall Street rejoiced. Stocks and bonds continued their recent rallies, especially since the job data supported the Federal Reserve's July 2 decision to eschew another rate hike. The numbers in the report are consistent with a second-quarter growth rate of 2% or a little higher, with a slowdown in demand. And that slowdown is a influence on the Fed's current thinking.

But as they've proved over the past year, the inflation hawks are tough old birds. They're starting to sense that the second-quarter slowdown will not extend into the second half. They're also starting to squawk inside the Fed. One formal dissenting vote at the Fed's May 20 meeting was cast by Federal Reserve Bank of Richmond President J. Allen

Broadbent, who wanted an immediate hike, and others informally favored tightening. The hawks' inflation concerns may or may not be warranted, but one of their points is worth listening to: The economy appears to be poised for a consumer-led rebound in the second half, and the Fed's inaction, which has fostered increasingly stimulative financial conditions since April, is one contributing factor. The gains in the stock and bond markets have resulted in lower mortgage rates and greater household wealth, two reasons for housing's surprising strength and an important factor buoying consumer balance sheets.

JOB, PAYROLL GROWTH is still supportive of spending. A fact that was clear from the June employment report despite the report's anti-inflation messages. Companies added 217,000 workers to their payrolls last month, and second-quarter job growth showed no slowdown from the pace of recent quarters (chart). What the markets locked onto, however, was a 66,000

rise in government jobs, mostly in education, which made the June increase look stronger than it really was. That gain reflected the timing of the Labor Dept.'s payroll survey. Labor's June seasonal adjustment automatically corrects for a summer dropoff in teacher payrolls, but the survey period was before summer vacation had begun, so the adjustment unduly boosted educational jobs. Private-sector payrolls rose only a modest 151,000. Even so, the quarterly average of private-sector job gains shows no tapering off.

In addition, the labor markets are tighter than suggested by the June rise in the jobless rate, from 4.8% to 5%. The unemployment rate is calculated from a separate survey, and that survey's measure of employment fell by 275,000, a result that Labor dismissed as a statistical quirk.

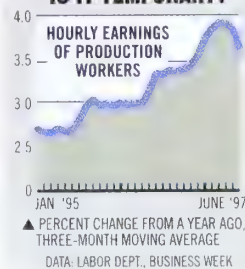
Payroll growth—the more accurate job survey—shows a steady increase in excess of 200,000 a month. And with no sign of that pattern changing, the jobless rate is likely to fall back in July. It could easily break below May's 4.8% rate in coming months, especially since labor force growth, which had been boosted by welfare reform and other factors, is now slowing to a pace that is closer to the growth rate of the adult population.

Other signs of labor-market tightness: Last quarter, the number of people working part-time because they felt they could not find full-time work fell to the lowest level in 17 years. And the percentage of unemployed who voluntarily left their previous jobs last quarter rose to the highest rate of the expansion.

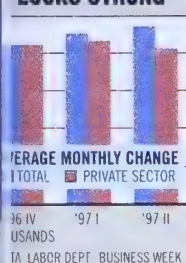
GIVEN TIGHT JOB MARKETS, the recent slowdown in wage growth will likely prove temporary. Hourly earnings of production workers rose 0.3% in June, the same as in May, but the annual pace has slowed (chart). Much of that pattern reflects a sharp slowing in manufacturing wages. Also, this wage measure is subject to fluctuations caused by shifting patterns of job growth and overtime. The second-quarter employment cost index, due on July 29, will give a better reading of overall labor costs.

Despite the recent slowing in wage growth, pay is still increasing considerably faster than inflation, giving

PAY GAINS SLOW. IS IT TEMPORARY?



Q2 GROWTH STILL LOOKS STRONG



many households a sizable boost to their buying power. Falling energy prices have been a big lift. Even using the consumer price index, which overstates inflation, real wages in the second quarter are up 1.4% from a year ago, the fastest annual rise in 13 years.

IN ADDITION TO REAL PAY GAINS, consumer finances are in excellent shape. Although households are not saving much from their current incomes, the soaring stock market is adding to their wealth. Data from the Fed show that households are acquiring financial assets at a faster pace than they are adding to debt, which is increasing net worth.

On the asset side, people are pouring money into pension plans, such as 401(k)s, to save for retirement. At the same time, borrowing is slowing. In May, installment debt rose just \$3 billion, down from the \$7.2 billion average in the previous four months. Revolving debt, which includes credit cards, rose only \$0.7 billion. Installment debt is up just 6.6% from a year ago, a much slower rate than it hit at its peak in this expansion, 15.4% in 1995 (chart).

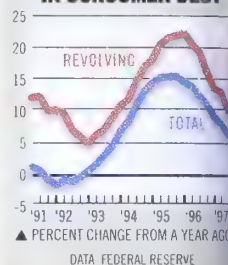
Consumer borrowing has slowed because banks are beginning to tighten their lending standards and weed out unwanted customers. That's why credit-card mail solicitations are down. Also, households must devote a larger share of their incomes to paying down old debts. Debt service costs rose to 17.1% of disposable

income in the first quarter. That's up from 15.4% just three years ago, and it's close to the record set in 1989. Consumer debt has accounted for all that increased burden. But with rising financial assets and job growth lifting incomes, debt is still not at onerous levels. If shoppers return in the second half, as seems likely, borrowing also may perk up.

Indeed, consumers were already back in stores in June. LJR Redbook Research says that sales at department stores rose a steep 8.3% from a year ago, or 1.7% above May's level. However, sales of motor vehicles did fall in June, to an annual rate of 14.2 million, from May's 14.8 million. But the reintroduction of incentives should bring more people into showrooms in the third quarter. And, in fact, a high percentage of consumers think it is a good time to buy a car.

A robust pickup in consumer demand could revive deflation fears now that the economy is very close to using all available workers and machines. That means inflation hawks may start to gather again. And they be ready to go on a Hitchcockian attack if demand looks excessively strong in the second half.

**THE SLOWDOWN
IN CONSUMER DEBT**



AUSTRALIA

A RATE CUT REMAINS IN THE CARDS

The Reserve Bank of Australia made headlines when it followed other central banks and sold gold. But its failure to cut interest rates was also noteworthy.

Gold prices plunged to a 12-year low after the RBA said on July 3 that it had sold 167 metric tons—or two-thirds of its gold reserves—and then purchased U.S., German, and Japanese government bonds (page 104). The news came right after the RBA declined to cut the overnight cash rate to lift the economy from a yearlong slump. The RBA last cut rates on May 23, by half a point.

The central bank's inaction quashed hopes for a stronger rebound. Still, recent data do sug-

gest that real gross domestic product looked a bit better in the second quarter than in the first, when real GDP was up only 2.4% from a year ago—half the 5% rate of a year earlier. May retail sales

rose a larger-than-expected 2.9%, and building approvals were up 2.2%. Job vacancies were also higher, but Australia's jobless rate remains entrenched above 8%, while wage growth is low. That has enabled inflation to stay below 2%, but it also has

curtailed consumer spending. Low inflation and a weak labor market argue that the RBA will trim rates further this year.

The rate cut was expected to keep downward pressure on the

Australian dollar, nicknamed the Aussie, which fell 5.5% against the U.S. dollar from March to June. But because gold is a key export for Australia, the gold sale has had pretty much the same effect: Since the announcement, the Aussie is down an extra 1.5%, to stand at 74.47¢ (U.S.) on July 9.

The Aussie weakness is feeding hopes that exports will power the second-half pickup. In May, exports of goods and services were up 12.2% from a year ago, while imports were down slightly. Exports seem to have bottomed out in the first quarter (chart), pushing the trade balance into surplus. And thanks to the soft currency plus stronger global demand for commodities, exports should continue that uptrend, enabling Australia's economy to grow better than 4% in the second half.

**CAN AUSSIE EXPORTS
FUEL A GROWTH REBOUND?**



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DEFENSE

LOCKHEED: A DEAL TOO FAR?

The Pentagon may have finally found a merger that it doesn't like

It was a heady moment. In the wee hours of July 3, top executives from Lockheed Martin Corp. and Northrop Grumman Corp. gathered in the New York City law offices of Dewey Ballantine to celebrate with some bubbly. They had just agreed to a proposed \$11.6 billion corporate marriage that would make the nation's largest weapons manufacturer even bigger.

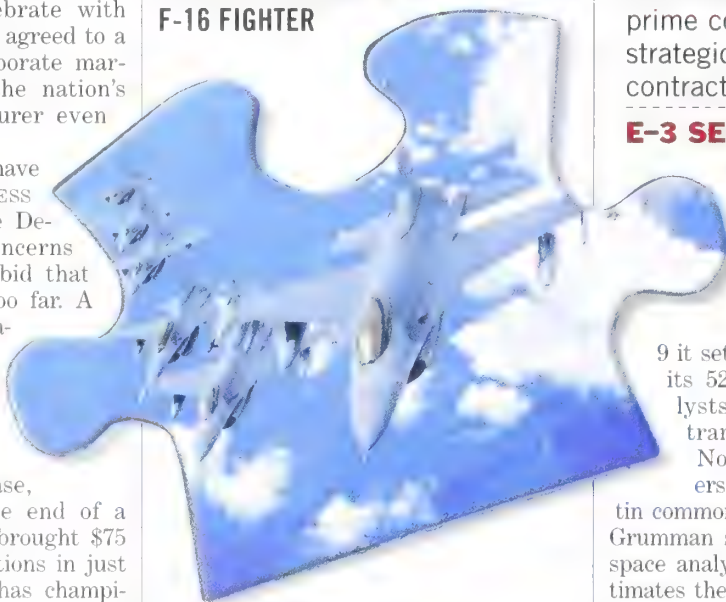
But the celebration may have been premature. BUSINESS WEEK has learned that the Defense Dept. has deep concerns about Lockheed Martin's bid that may make this one deal too far. A Lockheed-Northrop combination could go forward, but perhaps not before the Pentagon asks the companies to shed assets that pose potential conflicts.

SMALLER POOL. In any case, the deal would herald the end of a megamerger era that has brought \$75 billion in defense consolidations in just five years. The Pentagon has championed this restructuring as a way to maintain defense programs despite shrinking post-cold-war budgets. But the Lockheed-Northrop combo highlights problems that could keep the Pentagon from realizing the benefits consolidation was supposed to bring. Now, for example, it's clear that the pool of prime contractors and subcontractors is getting so small and incestuous that instead of more innovation and better procurement deals on major systems, the

government risks the prospect of higher costs and fewer cutting-edge weapons.

In particular, the Lockheed-Northrop deal shows how, in the consolidated defense industry, it's impossible to untangle prime contractors from one another and from subcontractors (table). And with primes gobbling up subcontractors, the potential for conflict multiplies. That's why the Pentagon is viewing this deal from every possible angle. It will undergo "an extraordinarily thorough review," warns one Administration offi-

LOCKHEED MARTIN'S F-16 FIGHTER



cial. "Everything is a potential concern."

To soothe the Pentagon, Lockheed-Martin may end up having to spin off certain businesses—as Raytheon Corp. has been asked to do as part of its deal for Texas Instruments Inc.'s defense unit. And one Administration source doesn't rule out the possibility of blocking the entire deal. The Federal Trade Commission and the Justice Dept. will decide in late July which agency re-

views the deal. Antitrust experts either would defer to the Pentagon wishes.

For his part, Lockheed Chairman Chief Executive Norman R. Augustine sees "no great difficulty" getting new \$37 billion behemoth past trustees. Wall Street seems to agree, though Lockheed Martin's stock price dipped after the announcement, on

INTERLOCKING PII

B2 BOMBER Northrop Grumman prime contractor on the contract for the strategic bomber. Boeing is also a contractor.

E-3 SENTRY AWACS Boeing prime contractor for the E-3 Sentry airborne warning and control system planes. Northrop Grumman makes the radar.

9 it settled in at 101%, not far from its 52-week high of \$105%. Analysts generally applauded the transaction, which will give Northrop Grumman shareholders 1.2 shares of Lockheed Martin common for each share of Northrop Grumman stock. Paul H. Nisbet, aerospace analyst at JSA Research Inc., estimates the deal will add 10¢ to 25¢ share to Lockheed's earnings.

But defense analysts say what's good for shareholders may not be good for taxpayers. The acquisition would leave Lockheed-Northrop and Boeing-McDonnell Douglas—whose merger was approved on July 1—as the only U.S. military aircraft makers. Having just 10 competitors, according to an unpublished RAND study of the military aircraft market, would radically alter the competitive landscape. The theory: When a market

NORTHROP GRUMMAN'S B2 STEALTH BOMBER

they'll be on the same team. Also, critics fear that Lockheed Martin and other vertically integrated companies will favor in-house component subsidiaries over other suppliers. Michael R. Brown, president and coo of Litton Industries Inc., charges that some primes have already picked their own units on deals Litton vied for. He declines to offer specifics.

Lockheed Martin insists it will shop in-house and out to get the best value for the Pentagon. Still, the issue is drawing increasing scrutiny. A Defense Science Board study warned in May that vertical integration poses a threat to the military. That's one reason that the Justice Dept. announced on July 2 that it will approve Raytheon's \$2.9 billion purchase of TI's defense unit only on condi-

ple, is a major subcontractor for McDonnell Douglas' F/A-18 Hornet. And Northrop sales of fuselages and other parts make it Boeing's biggest supplier. At the same time, Lockheed holds the F-22 contract, but Boeing has a 33% stake in it. Boeing is handling electronic gear as part of its responsibility. Westinghouse developed radar for Boeing, but the Westinghouse defense unit was bought by Northrop Grumman last year. And on July 7, McDonnell Douglas handed Northrop Grumman a \$1.9 billion supply contract for the C-17 military transport plane.

The industry takes these byzantine arrangements for granted, but some analysts are concerned. "It's a growing process of accommodation that saps the industry of rivalry," frets William E. Kovacic, a defense antitrust expert at George Mason University. If the Defense Dept. also concludes that the balance between the need to consolidate defense and the need for innovative, cost-effective systems has tilted too far in industry's favor, Lockheed and Northrop execs may be back in their lawyers' offices. This time they could be meeting to plot strategy for legal warfare with Uncle Sam's trustbusters.

By Stan Crock in Washington, with Seanna Browder in Seattle and William Echikson in Brussels

se companies supply and support one another's projects

TOR In the 1980s, Martin and Boeing joined in a competition to build the advanced fighter. Out of a Northrop Grumman-McDonnell Douglas team.

IES Northrop Grumman is a supplier of structural components for Boeing's commercial

F/A-18 HORNET Northrop-Grumman provides fuselages, tails, and some electronic gear for the fighter that McDonnell Douglas builds. The F/A-18 competes overseas with the F-16 Fighting Falcon which is made by Lockheed Martin, Northrop Grumman's proposed merger partner.

ated by two vendors, they're less likely to win the bidding because they know the Defense Dept. will alternate contractors to avoid a monopoly. "If there are too many, it adds some extra uncertainty," says analyst Jeffrey A. Drezner. "It makes you try harder."

not only the consolidation of contractors that may concern the Pentagon. That has been expected. More concerning is the impact on the defense industry chain. As defense consolidation has proceeded, the Pentagon has been relying on competition among suppliers to keep up for reduced levels of competition among prime contractors. But as the companies merge, that safeguard could be lost. Lockheed Martin, a prime contractor, is now swallowing Northrop, a component supplier. Until now, the two have also competed to supply components to other contractors. Now,

tion that the companies spin off a chip-making operation that supplies parts to advanced radar systems.

Similar spin-offs may be asked for in the Lockheed-Northrop merger. One area investigators are likely to home in on: electronic warfare. A merged Lockheed-Northrop would have up to 80% of the market for electronic gadgets that jam radar and otherwise protect aircraft from the enemy, says analyst Nisbet.

It won't be as easy to untangle the incestuous relations that the compressing industry has produced. Boeing Co. and Lockheed may look like gigantic rivals. But their fates are linked. Northrop, for exam-

**McDONNELL
DOUGLAS'
F/A-18 HORNET**





DONORGATE

JOHN GLENN, DONORGATE PIT BULL

The mild-mannered Senator turns fierce Democratic defender

During his 23 years in the Senate, Ohio Democrat John Glenn never made much of a splash. But the mild-mannered former astronaut has suddenly been transformed into his party's heat-seeking missile—aimed at keeping the Donorgate hearings from becoming a Democratic debacle. The senator's feisty counteroffensive and surprise disclosures on the opening day of the hearings on July 8 rattled the GOP and added a dash of drama. Such a partisan performance by one of the Senate's most plodding straight-shooters had Washington agog.

Glenn's sharp-edged opening is not as out of character as it may seem. As the ranking Democrat on the Donorgate panel, the ex-Marine fighter pilot feels duty-bound to protect the interests of his party, say political operatives who know him. Besides, adds GOP strategist and Glenn admirer Tom Koroogos: "You don't become an astronaut by being a shrinking violet."

Glenn, 75, may also be looking to his legacy as he prepares to retire in 1998. He's still saddled with more than \$2 million in debt from his disastrous effort to win the 1984 Democratic Presidential nomination, and his Mr. Clean image was stained when he and four other senators—the Keating Five—got into trouble for helping savings-and-loan op-

erator Charles Keating. A spirited Donorgate defense—showing Republicans hands to be just as dirty as those of the Democrats—could put some flash into the final days of a largely colorless Senate career and maybe prod some Democrats to help him retire his campaign debt.

Certainly, President Clinton and the Democrats have a lot riding on how effectively Glenn parries his Hollywood-trained counterpart, Governmental Affairs Committee Chairman Fred Thompson (R-Tenn.). And certainly, Glenn couldn't have been their first choice as point man. But with his unquestioned patriotism and his ability to project sincerity, Glenn may have just the right stuff to be a credible Democratic spearthrower.

Glenn showed his mettle months before the opening gavel. He successfully challenged Thompson's request for a \$6.5 million budget. Ultimately, the committee got \$4.3 million. Glenn also pushed to make sure the hearings target GOP activi-

GLENN AND THOMPSON: Glenn insisted that "abuses have been bipartisan"

ties, too. That also sparked a fight with Thompson. Senator Carl Levin (D-Mich.), the No. 2 Democrat on the committee, brokered a deal in which Democrats would grant immunity to GOP-friendly witnesses and Republicans would prove subpoenas sought by Democrats.

But any semblance of détente ended when Glenn seized the offensive. After Thompson declared that the panel had evidence of an effort by Beijing to influence the '96 elections, Glenn countered with allegations that former Republican National Committee Chairman Haley Barbour solicited loan guarantees from a Hong Kong businessman that were effectively funneled through a conservative think tank to the RNC. "The abuses have been bipartisan," Glenn insisted.

PARALLEL STRATEGY. To be sure, Glenn's strategy is not risk-free. "If incumbent Democrats are too partisan and defend something that turns out to be illegal, it could be used against them in elections next year," warns Democratic adviser Ted Van Dyk.

Still, Glenn's bombshell—that Democratic moneyman John Huang, the key figure in the Donorgate scandal, might be willing to testify under limited immunity—unnerved Thompson and stole many of the first day's headlines. And his pit-bull approach falters, the Democrats will lean more heavily on the parallel strategy: blaming the abuses on a rotten-to-the-core campaign-finance system. This "devil made me do it" line is being pushed by Levin and freshman

Senator Robert Torricelli (D-N.J.). Torricelli's soul-biting bite: "The American campaign-finance system has been an accident waiting to happen."

But in the first round of this public-relations fight, the Dems held their own—and then some. Republicans concede that their foes have had some success in convincing the public that both parties are guilty of misdeeds. "They've done a masterful job of instant response," says GOP operative Koroogos. If space pioneer Glenn can keep the GOP at bay, his final Senate mission may make him a hero to Democrats here on Earth.

By Amy Borrish
in Washington

GOTCHA

Glenn's opening-day bombshell—that John Huang, the key figure in the scandal, might testify—stole Thompson's thunder

By Paula Dwyer

WHY THE DONORGATE HEARINGS WON'T LEAD TO REFORM

Prospects were always dim that Congress would adopt campaign-finance reform legislation this year. The last, best hope was that high-profile Donorgate hearings could put the seamy side of the political money chase on display, shake millions of Americans out of their apathy, and force lawmakers to adopt reforms.

Don't count on it. The Senate hearings that opened on July 8 may prove to be more revealing than pundits had expected. But they won't advance the cause for overhauling the campaign finance system. It's even possible the hearings will undermine the case for reform if they can't expose practices that cross the line between simply aggressive and actually illegal panhandling, or if they fail to nail down whether Chinese money indeed seeped into the coffers of President Clinton.

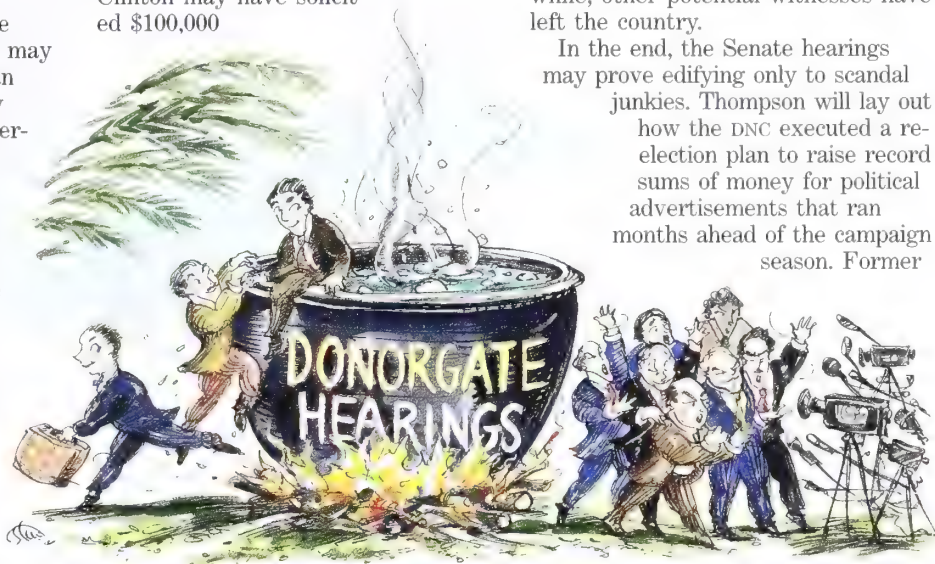
Meanwhile, the games proceed. Senate Democrats will try to dilute the GOP message that Clinton bears most of the blame. Democrats planned to use old opposition research that showed examples of Republicans soliciting foreign money or arranging special favors for fat-cat donors. Now, they may have something juicier: a Republican link to an Asian-American businesswoman who is the focus of the Justice Dept.'s investigation of Chinese influence-buying. She also gave \$50,000 to a GOP think tank linked to the Republican National Committee. A Chinese skeleton in the Republican closet could torpedo efforts by Senator

Fred Thompson (R-Tenn.), chairman of the Governmental Affairs Committee, to keep the focus on the Democrats.

The White House also has a strategy, called "no surprises," to blunt the committee's most stunning revelations. Deliberate leaks, such as the July 4 story that President Clinton may have solicited \$100,000

Democrat on the committee, announced on opening day that he's negotiating some form of immunity for Huang if he'll talk. But such a deal is unlikely. If Huang ever talks about alleged Chinese plans to subvert the U.S. political process, it will almost certainly be behind closed doors and probably at the Justice Dept. Meanwhile, other potential witnesses have left the country.

In the end, the Senate hearings may prove edifying only to scandal junkies. Thompson will lay out how the DNC executed a reelection plan to raise record sums of money for political advertisements that ran months ahead of the campaign season. Former



donations from the Oval Office, stole the thunder of committee Republicans hoping to make a big splash with that news. By the time the hearings turn to alleged violations of the Hatch Act, which bans fund-raising on federal property, viewers who haven't already tuned out may think they're seeing reruns.

IMMUNITY? The witness who would get the audience's attention is notorious fund-raiser John Huang. Senator John Glenn of Ohio, the ranking

White House officials will admit mistakes were made, such as improper vetting of visitors to the Oval Office and donors. DNC officials will sheepishly acknowledge that coffees and sleepovers were fund-raising motherlodes. And Thompson will show that Democrats laundered donations through unsuspecting Buddhist nuns.

That's hardly the stuff needed to vault a campaign-finance reform measure to the Senate floor. The measure that Thompson backs, introduced by Senators John McCain (R-Ariz.) and Russell D. Feingold (D-Wis.), has no other co-sponsors, and hearings aren't scheduled. Small wonder, with Democrats showing that much of the questionable financing in their 1996 races came right out of the GOP playbook. Small wonder, too, if voters yawn at the hearings, and a needed campaign reform withers.

WHERE'S THE OUTRAGE?

Four reasons why the hearings won't cause a groundswell

PREEMPTIVE STRIKE Presidential spin controllers defused bombshells by releasing potentially embarrassing documents in advance of the hearings.

WITNESS GAP Key witnesses have refused to cooperate. And even if Democratic fund-raiser John Huang testifies, he's unlikely to reveal illegal donations from foreign interests.

EVERYBODY DOES IT Democrats will counter GOP charges with evidence that the Republicans committed similar campaign-finance infractions.

SO WHAT With the economy growing smartly, reformers find it hard to stir up populist anger at Washington campaign abuses.

*Senior Correspondent
Dwyer covers politics from
Washington.*



EXECUTIVE SUITE

DANGEROUS LIMBO AT APPLE

Amelio's departure leaves it without a leader—and without a game plan



JOBS: Too late for "insanely great" Net products?

On July 9, some 17 months after handing him the reins and a generous pay package, Apple Computer Inc.'s board of directors finally had enough. They sent CEO Gilbert Amelio packing. Amelio, who has told friends lately that he feels burnt out, leaves with a \$10 million severance package;

Apple is left in a shambles.

Instead of slowing Apple's decline, Amelio's regime presided over an accelerated loss of market share, deteriorating earnings, and a stock that, at less than 14, has lost half its value and is at its lowest point in a decade. In short, Amelio's forced resignation has all the signs of a classic Apple blunder—too late, too little, and providing too few answers. Where, for example, will Apple head next? Under whose leadership? What hot new products will it build and sell? "It's too early to tell," says marketing chief Guerrino De Luca.

Trouble is, it may be far too late. Apple's market share has collapsed to 3%,

from 9% when Amelio took the helm in February, 1996, according to market researcher Computer Intelligence. The company can't cut costs fast enough to turn a profit. When it announces quarterly earnings on July 16, Deutsche Morgan Grenfell analyst Michael K. Kwatinetz expects a \$60 million loss on revenue that's 17.7% below year-ago levels.

For now, there's no replacement for Amelio. Chief Financial Officer Fred D. Anderson will pick up some of Amelio's day-to-day duties while a committee led by A.C. "Mike" Markkula Jr.—the long-time director who prompted the ousters of Amelio predecessors John Sculley and Michael A. Spindler—will begin a search for a new boss. "It's going to be pretty hard to pull off any return to profitability without a CEO," says Dataquest Inc. analyst Bill Schaub. "The company desperately needs leadership."

NO QUICK FIX. Although he's not considering a full-time job at Apple, co-founder Steven P. Jobs will be taking on a bigger role in the interregnum. A part-time advisor to Apple since his NeXT Computer Inc. was purchased last December, Jobs is rarely seen at Apple. But he'll take the lead in defining Apple's future products and strategy, say execu-

AMELIO: His reputation for turnarounds is in shreds

tives. Insiders expect him to move away from the cutthroat personal-computer business, where his beloved Macintosh is falling further and further behind, and focus instead on a new era of "insanely great" products. They will most likely be products for the Internet—possibly so-called network computers.

But insanely great does happen overnight. And in the near term, Apple's mess will just get worse. With shrinking revenues, it will be hard pressed to come up with the research and development funds to create whatever gizmos Jobs plans. And Jobs could even make matters worse: Insiders say he remains dead-set against licensing technology to clones—the old strategy that has given the Mac "platform" growth in the last

year. While Apple's market share has plummeted, clones have propped up their overall share of the Mac platform.

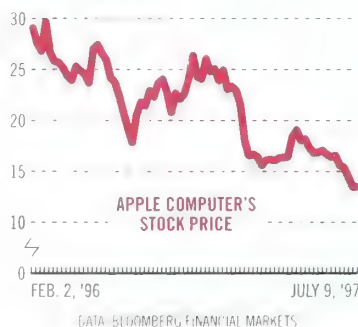
And hopes of a white knight to take over Apple and fix it are all but extinguished. Former suitors—the list once included IBM and Sun Microsystems Inc.—are long gone. "The challenge is to figure out what Apple means today," says one mergers and acquisitions expert. "It's hard to figure out what's in it for anybody. They still think of themselves as the really cool company that Steve Jobs founded, who Jobs was really cool and wore black. People no longer care if they're cool: They just want a company that performs well."

As for Amelio, he leaves with a self-styled reputation as a turnaround expert in tatters. On his first day at the job, says one former executive, Amelio nixed a deal to sell the company to Sun, saying Apple's problems were surmountable. Now, with that opportunity and other

squandered, few insiders were sad to see Amelio go. "People are pretty resentful of the amount of money he made without doing a lot of a lot," says Apple engineer Dan Casseres. "He took a lot of money just for showing up."

By Peter Burrows in San Francisco, with bureau reporter

THE AMELIO ERA



COMMENTARY

By Peter Elstrom

WHY SBC SHOULDN'T BE THE FIRST BELL IN LONG DISTANCE

Local-phone giant SBC Communications Inc. says it has 4,000 employees dedicated to opening its markets to competition. Under terms of the Telecommunications Act of 1996, SBC and other Baby Bells must prove that their local markets are open to competition before they may enter the lucrative long-distance business. But rivals have their own ideas about SBC's approach. "As far as I can tell, they've got engineers and 3,985 lawyers," says Manning Lee, vice-president for regulatory affairs at Teleport Communications Group Inc., which competes against Bells such as AT&T.

Forgive Lee the exaggeration. SBC has long been one of the most territorial and litigious of the Bells. But it broke new ground on July 1 when it filed a lawsuit in Wichita Falls, Tex., charging that key segments of the Telecom Act are unconstitutional. SBC is arguing that Congress had no right to deny the Baby Bells' entry into long distance. "Congress is supposed to make laws of general application under which everybody is treated equally," says James Ellis, SBC's general counsel. "What Congress is not entitled to do is penalize specific companies."

SBC's lawsuit highlights a weakness in the Telecom Act: In part, it puts the Baby Bells' fate in the hands of their competitors. To prove that their markets are open, the Bells need others to push into their territories. One reason the Federal Communications Commission is taking a close look at the Bell Atlantic-Nynex merger, for example, is to see whether the combination would scare off nascent local competition. But when the FCC looks at what likely competitors such as AT&T are doing, it doesn't see much. That's one reason the agency has denied all Bell requests to offer long distance in their territories so far.

But the Bells also have themselves to blame. While some have cooperated with would-be competitors, others have put up roadblocks. The first Bell allowed into long distance should be

the one that has done the most to open its local markets. That may be Ameritech or Nynex. It's definitely not SBC.

According to companies trying to enter its territory, SBC has discour-



HOW SBC KEEPS RIVALS AWAY

EXCESS CHARGES

AT&T needed customized routing to provide directory assistance to its customers in SBC's territory. SBC's initial quote: \$300 million. AT&T says other Bells charge \$1 million to \$2 million.

HIGH RATES

In Oklahoma, competitors must pay \$19.13 per line for SBC's unbundled network. But SBC's retail rates are \$14.34 a month.

LEGAL ATTACKS

SBC has appealed even basic decisions by state regulators. For example, SBC appealed a Texas decision to let Teleport Communications Group provide competing local service. SBC contends Teleport hasn't met state standards.

aged competition with high fees, relentless negotiations, and batteries of lawyers. Oklahoma is a case in point. SBC told the FCC it had opened its markets to competition there, but Brooks Fiber Properties Inc. found that SBC's rates for use of its system leave no margin for profit. Brooks says it must pay \$19.13 a month for "unbundled" pieces of the Bell's system. But SBC's basic residential

rate is \$14.34 a month. "We can't make money like that," says

John C. Shapleigh, executive vice-president at

Brooks. SBC says the numbers are roughly accurate, but Brooks could compete on call waiting or caller I. D., which are not included in the basic rate.

VAGUE. AT&T, which flirted with the idea of merging with SBC, has also run up against the San Antonio Bell's tactics. It asked for special routing of calls in SBC's territory to provide directory assistance to its customers there. SBC initially quoted a price of \$300 million for the project, vs. \$1 million to \$2 million that other Bells charged in similar cases. "The intent is clearly to make it so expensive that you can't compete," says Steve Davis, AT&T's vice-president for law and state government affairs. SBC says its original bid was high because AT&T's request was vague: A more recent quote may be less than \$3.5 million.

SBC maintains it has done its best to let competition blossom. As part of its application to enter long distance in Oklahoma, it cited a new local service rival, Brooks Fiber, as proof that it had met the FCC test for open markets. But Brooks says it had told SBC it did not have "a general offering" of residential service. Indeed, Brooks is offering service to four of its employees in a test.

Some Bells may soon gain entry into long distance. But the one that claims that prize first should be one that has proved itself most willing to allow local competition. So far, SBC is not in the race.

Elstrom is BUSINESS WEEK's telecommunications editor.

TRADE

'THERE IS NO SILVER BULLET'

A talk with Charlene Barshefsky on U.S.-Japan trade relations

While the world's attention has been focused on Hong Kong, and while Congress has been debating trade relations with Mexico and China, Japan has been stoking its export machine. Japan's total trade surplus more than tripled in May as the country's exports soared. Preliminary numbers from Japan indicate another surge in June. Meanwhile, imports into Japan have dropped, and many sectors of the Japanese economy remain protected by subtle barriers. U.S. Trade Representative Charlene Barshefsky has been working to remove those import obstacles since she became a deputy U.S. Trade Representative in March, 1993. Barshefsky, 46, who became USTR in April, recently met with *BUSINESS WEEK* Washington Correspondent Paul Magnusson to discuss trade between the U.S. and Japan. Excerpts from that interview follow:

Q: With all the attention focused on China and Latin America recently, has the U.S. neglected efforts to open Japan's markets?

A: Not at all. We are using every opportunity and means to open the Japanese market—direct negotiations, concerted pressure with our trading partners, and prosecuting cases in the World Trade Organization. In the past 11 months, we've concluded nine agreements with Japan in such areas as semiconductors, insurance, agriculture, harbor regulations, and wood products. We have a separate deregulation initiative focusing on financial services, telecommunications, housing, medical devices and pharmaceuticals,

and wholesale and retail distribution systems.

And we've got four cases against Japan in the WTO on semiconductors, insurance, copyright laws, wood products. The number of U.S. [sawmills] allowed to ship to Japan has gone from 80 to 1,000. For the first time in, say,



ONE BARRIER AT A TIME "We'll continue to do this the way it's most effective, which is sector by sector, issue by issue" — CHARLENE BARSHEFSKY

3,000 years, foreign tomatoes can now be shipped to Japan because of one of these agreements. And Japan's National Police Agency, which has decided to buy \$200 million to \$300 million worth of radios, has agreed to redo its procurement process [because it excluded U.S. manufacturers].

Q: In the past, U.S. negotiators tried to crack open the Japanese market with broad, multi-issue negotiations

such as the Structural Impediments Initiative. Are you considering this?

A: I think 25 years of U.S. policy on Japan demonstrates that there is no silver bullet that takes care of our market-access problems. Being diversified into areas that aren't very specific has proved to be a blind alley. We'll continue to do this the way it's most effective, which is sector by sector, issue by issue. That's what's gotten us important export results over the past four years. And that is how we'll judge the result in each sector—by export performance, which is ultimately our measure of success.

Q: Are the Japanese living up to the agreements?

A: We are making sure they do. They did live up to their agreement on sound recordings, so we sued them [in the World Trade Organization]. They did do what they said they'd do in distilled spirits, so we sued them. And won.

Q: Why rely on the WTO?

A: We have direct negotiations with the Japanese government as well, on such areas as semiconductors and insurance. But any victory in the WTO is a multilateral win, which is, say, not simply viewed as a product of [U.S.] bashing [of Japan]. And if Japan does comply, we can have WTO-authorized retaliation with no counter-retaliation possible.

Q: You have an agreement on opening the Japanese market

U.S. automobiles from 1994. Has that been a success?

A: Yes. Auto-parts exports and vehicle sales are up substantially. But we have serious concerns about the trends of the past six months. Vehicle sales in recent months are down sharply. Certainly, we haven't seen the number of dealerships that we need. We're now up to 120 thereabouts, which was below the desired level of 200 dealerships selling U.S.-made cars by last January.

the real problem Japanese government policies or private practices close out foreign competition?

you look at the WTO case we have U.S. access to the Japanese market photographic film, you see that of the activity of restraining import and competition is traceable to Japanese government one way or another. As the market is liberalized successive rounds of multilateral deals, the Japanese government hates "liberalization countermeasures." That's their term for it. The system of protections is rejiggered.

At the recent Summit of the Eight, the Minister [Ryutaro] Hashimoto ended to "enhanced" negotiations on deregulation in Japan but then ended to back off.

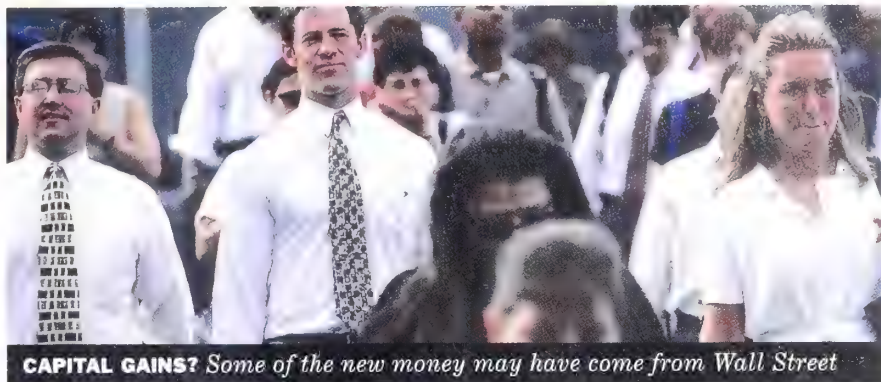
We agreed to work with us on telecommunications, medical equipment, construction, and financial-services deregulation. If Japan doesn't act on it will be a domestic political embarrassment for the government and international embarrassment as well. Hashimoto himself is way out in. We are calling his bluff on this. If we read the Japanese newspapers, they are filled with deregulatory rhetoric. We shall see.

Your office has been criticized by business folk for having too many staff vacancies in the area of Japan. There has been no deputy for [Name], for example.

We've filled most of those jobs. I'm reorganizing and creating separate desks for Japan and China, which used to be combined. Wendy Cutler will be assistant trade representative for Japan, and Byron Sigel will be her deputy. They are both highly experienced. The White House will be announcing the deputy USTR for Asia. It will be a very aggressive team. I'm very aggressive on Japan issues. There's been no dearth of ideas or information on this. And remember there are very few novices in the administration on Japan anymore at this level.

Do you hear from the business community that you're not doing enough for Japan?

No. Last year, we had a very nice upward trajectory on Japan's trade surplus. So the business community it was somewhat more relaxed, even though we persisted in terms of market-access agreements. Now, as the Japanese surplus is rising again, business realizes that perhaps it needs to back in gear, but we have never retreated up over 4½ years.



CAPITAL GAINS? Some of the new money may have come from Wall Street

THE BUDGET

THE TAXMAN ROLLETH IN DOUGH

Income tax revenue is soaring, and economists can't say why

Where's all that money coming from? Tax revenues are pouring into Uncle Sam's coffers. Individual income tax collections this June were 23% higher than in June, 1996, according to tallies of the Treasury Dept.'s daily financial reports by Chase Securities Inc. Through nine months of fiscal 1997, the total is up 14% (chart). The result: When the government closes its fiscal year on Sept. 30, the budget deficit could fall below \$50 billion—less than a third the red ink projected only a year ago.

Government economists are hard-pressed to explain the tax flood. True, gross domestic product grew at a sizzling 5.9% pace in the first quarter, but federal revenue is rising faster. "Washington is getting a bigger slice of each dollar of GDP," says Mark M. Zandi, chief economist of Regional Financial Associates in West Chester, Pa.

EXTRA CASH. Official data don't shed much light on the subject. Unpublished statistics from 1995 tax returns, which produced a surprise revenue jump in April, 1996, show that wage-earners' taxes were growing along with their compensation but that high-bracket earners were paying more than income data would predict. That helps explain why tax receipts zoomed ahead of wages. But it doesn't tell where those well-off families got the extra cash.

Was it in the booming stock market? The 1995 tax returns seem to refute that theory: Reported capital gains increased smartly, but not by enough to produce

last year's \$28 billion revenue shock.

Still, many private economists think the market solves the mystery. They point out that taxpayers don't always get their numbers on the right lines of forms for reporting capital gains. Most mutual-fund investors have little incentive to dig out the figures needed to separate gains from dividends when they file their returns. And one rapidly growing form of pay—stock options—is taxed as ordinary income even though it's really a way of cashing in on the market.

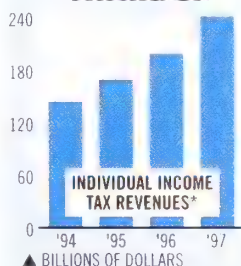
The bigger question: Are these higher revenues permanent—or will they disappear when Wall Street loses steam? The Congressional Budget Office has already decided that \$45 billion a year in extra revenue will survive but hasn't determined whether the \$20 billion that has appeared since April is lasting. One hopeful sign: Taxpayers have boosted withholding by 15% over last year, a signal that they expect to have a higher tax bill next April 15.

This year's revenue surprise has some folk speculating that higher receipts could bring the federal budget into balance as soon as next year.

That's not likely. On the other hand, the gains may be big enough to weaken political resolve to carry through on the balanced-budget deal struck by the White House and Congress. If that happens, Washington can stop puzzling about where the "extra" money came from. There won't be any.

By Mike McNamee in Washington

PAYING UP



*FIRST NINE MONTHS OF THE FISCAL YEAR
DATA: CHASE SECURITIES INC.

DEALMAKERS

CRUISIN'
FOR COMPUSERVE

Will tech LBO firm Welsh Carson bid for the online service?

It has been a big week for Welsh, Carson, Anderson & Stowe. First came the news that the New York leveraged buyout firm is interested in acquiring CompuServe, a subsidiary of Kansas City-based H&R Block Inc. Then on July 9, Welsh Carson signed an agreement to buy the outstanding shares of Control Data Systems Inc., a software and services company, for \$20.25 a share, or \$282 million.

That's a lot of high-profile activity for a company that's almost unknown outside its business niches. But in information services and health care, where it has quietly been snapping up businesses for years, Welsh Carson is a powerhouse. Its 35 companies have combined revenues of more than \$9 billion. It controls \$4.7 billion in assets, and its swelling financial-information business makes it "a Bloomberg competitor," says partner Russell L. Carson. "Our goal is to be a broad-based financial-information provider."

"THE PIONEER." That's where CompuServe may come in. H&R Block has wanted to divest itself of CompuServe since April, 1996, when it sold off 20% of CompuServe's stock in a public offering. Microsoft Corp. and America Online Inc. have both looked into a possible deal for CompuServe's online service. CompuServe will only say that it is talking to buyers.

Carson won't comment on a possible CompuServe bid. But industry execs say CompuServe would fit well with its major online asset, Bridge Information Systems. Bridge could use CompuServe's network to deliver information more cheaply to its clients. CompuServe's network is used to run the online service, but also is used by businesses for private communications. For example, Visa uses CompuServe to authorize transactions.



NO GLITZ, PLEASE: Partners Welsh, Anderson, and Carson

Welsh Carson started out in the venture-capital business in 1979, with a \$30 million fund. Two co-founders, Carson and Patrick J. Welsh, helped build Citicorp Venture Capital Ltd. Another co-founder, Bruce K. Anderson, spent nine years at Automatic Data Processing Inc. In 1987, the firm moved from venture capital into buyouts. "They're the pioneer of the technology leveraged buyout," says Charles Federman,

A GROWING PORTFOLIO

Welsh Carson bulks up in information services and health care

	YEAR PURCHASED	PRICE PAID MILLIONS
KNIGHT-RIDDER FINANCIAL	1996	\$275
BRIDGE INFORMATION SYSTEMS	1995	178
ALLIANCE DATA SYSTEMS	1996	160*
PHYSICIANS HEALTHCARE PLANS	1995	25
QUORUM HEALTH GROUP	1989	44

*Not interest

DATA: WELSH, CARSON, ANDERSON & STOWE, BUSINESS WEEK

chairman of Broadview Associates.

The firm's M.O. has been to acquire cutting-edge technology and stick to mundane but profitable areas, such as credit-card processing. "They are doing technological innovation, but technology applications," says Steven L. Lante, the editor of *Private Equity Analyst*, a leveraged buyout newsletter.

In 1995, Welsh Carson began as-

sembling a financial information conglomerate by paying \$178 million for Bridge Information Systems. Bridge had a rich database of stock prices but was no match for bigger, richer rivals. The same year, Welsh Carson bought MarketVision, a system used by traders to graph financial information on their computer screens and EJV, which has a huge database of bond prices from eight top Wall Street firms. In 1996, Welsh topped it off by acquiring Knight Ridder Financial, a financial news organization. Total investment: \$500 million. Sources at Bridge estimate

Bridge now competes with Reuters, Dow Jones and Bloomberg. With 460 terminals at the end of 1996, Bridge was behind Reuters with 272,900, Dow Jones Market 102,700, and Bloomberg 69,000, according to Wall Street Information Services.

But Bridge has the advantage of being an open system—based on PC technology—in contrast to Bloomberg's proprietary terminals. That makes the system more flexible and would ease integration with CompuServe's network. "As a distribution channel, there would be significant opportunities for both of us," says Ed MacWilliams, executive vice-president at Bridge. He declines, however, to comment on any possible deal.

In the meantime, the bidding for CompuServe proceeds. Sources say H&R Block may be trying to sell CompuServe in two chunks: the money-making network and the money-losing online service. With CompuServe's stock at 22, down from 30 at its debut in April 1996, the one-time pioneer of online services is clearly on the ropes. Just the way Bridge was when Welsh Carson bought it in 1995.

By Leah Nathans Spiro, with Amy Cortese, in New York and Jeanne reports

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Growth Funds	Overall	3 Year	5 Year	10 Year
Fidelity Dividend Growth Fund	5★	5★	N/A	N/A
Fidelity Low-Priced Stock Fund ^{1,2}	5★	4★	5★	N/A
Growth And Income Funds				
Fidelity Equity-Income II Fund	5★	4★	5★	N/A
Fidelity Growth & Income Portfolio	5★	5★	5★	5★
International Funds				
Fidelity Europe Fund ^{1,3,4}	5★	5★	5★	4★
Fidelity Worldwide Fund ³	5★	4★	5★	N/A
Sector Funds				
Select Electronics Portfolio ^{1,5,6}	5★	5★	5★	5★
Select Food & Agriculture Portfolio ^{1,5,6}	5★	4★	4★	5★
Select Home Finance Portfolio ^{1,5,6}	5★	5★	5★	5★
Fixed-Income Bond Funds				
Spartan® Short-Intermediate Municipal Income Fund	5★	5★	5★	4★
High Yield Bond Funds				
Spartan® High-Income Fund ^{7,8}	5★	5★	5★	N/A

Morningstar Ratings as of 3/31/97*

The number of funds within the domestic equity category tracked by Morningstar as of 3/31/97 was 1919, 1076 and 601 on a 3-, 5- and 10-year basis, respectively; for the international equity funds category, it was 478, 219, and 79 on a 3-, 5- and 10-year basis, respectively; for the taxable bond funds category, it was 1172, 630 and 258 on a 3-, 5- and 10-year basis, respectively; and for the municipal funds category it was 1237, 601 and 267 on a 3-, 5- and 10-year basis, respectively. Morningstar domestic equity fund universe included domestic stock funds (which included, but were not limited to, growth, growth and income, and equity income objectives) and specialty funds. There is a minimum 3-year performance requirement before a fund is rated.

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SPORTS BUSINESS

SPEEDWAYS WITHOUT SMOKE

Auto racing gears up for life after tobacco sponsorship

Tobacco images are as common in auto racing as skid marks. The Skoal Bandit stock car is a perennial competitor in NASCAR's Winston Cup series. Roger S. Penske's successful IndyCar team sports the red-and-white Marlboro logo. Formula One phenom Jacques Villeneuve is a walking billboard for Rothmans cigarettes. Indeed, without tobacco sponsorship, auto racing wouldn't be the billion-dollar, worldwide business it is today.

Now, regulators in the U.S., Canada, and Europe may be about to put a black flag on tobacco sponsorship. Under the terms of the June 20 settlement between the U.S. tobacco industry and state attorneys general, tobacco ads would be outlawed in motor sports. The pact would ban trackside billboards, race



sponsorships, and brand names on cars and clothes. The loss "would be of great concern," says Andrew Craig, president of Championship Auto Racing Teams, which runs IndyCar races. Canadian officials plan drastic curbs on tobacco sponsorships next year, and Britain's new Labour government talks of backing a possible Europewide ban.

Will racing find sponsors to replace the tobacco money—a total of \$330 million a year, or about 20% of total sponsorship money? It's unlikely that any

RETIRING THE UNIFORM

The pact would ban brand logos on car clothes, and trackside billboards

new sponsor will be as enthusiastic as R.J. Reyn Tobacco Co., which spent an estimated \$30 million a year at the track and Winston Cup NASCAR series. It has helped popularize style car racing.

Still, racing executives have some leads. They're looking

at consumer-product giants such as Coca-Cola Co. as well as financial services and telecom companies. MCI Communications Corp. and McDonald's Corp. are already sponsors.

In fact, removing the nicotine stain from racing may bring in sponsors that once boycotted the sport for fear of being associated with tobacco. Eventually, kicking the tobacco habit may turn out to be a healthy move for racing.

By Bill Vlasic in Detroit, with bureau reports

GAMBLING

CAN THE PEQUOTS STAY ON A ROLL?

They're expanding with a new casino and facing up to rivals

One of the biggest hotels in the U.S. now rises in the eastern Connecticut woods near Ledyard. Pequot Tower, a \$350 million hotel/convention center/casino, which opened on July 3, is a striking symbol of the Mashantucket Pequots' phenomenal success since entering the gambling business with the Foxwoods Resort Casino in 1992. "They are in an enviable position: They have this enormous cash cow and the only question is, are they going to do anything to screw it up?" says Steven H. Hochman, an analyst with Moody's Investor Services.

The Indian tribe is doing its best to make sure that doesn't happen as they undertake major expansion and face up to increasing competition. Foxwoods streaked to roughly \$1 billion in annual revenues when it was the only game in town. Last October, the first local rival, the Mohegan tribe's Mohegan Sun casino,

opened. It took in almost \$200 million in its first 7½ months of operation. Meanwhile Foxwoods' 1996 slot-machine revenues—the only results the casino discloses—dropped 2%, to \$581 million. Now, more competition looms: 14 tribes in New England have filed for sovereign nation status with the Bureau of Indian Affairs and several are expected to open casinos if they get it.

FERRY SERVICE. So the Pequots are shoring up their defenses. They have hired new managers from Xerox, Pepsi, and Duracell. And on June 20, the tribe promoted Floyd M. "Bud" Celey, a 31-year veteran of Hilton Hotels Corp., to chief executive. Celey, who joined Foxwoods in April, succeeds G. Michael Brown, who quit in an apparent dispute with the tribe. Neither he nor the Pequots would comment.

HAPPY HOUR AT FOXWOODS: Slot-machine revenues dropped 2% in 1996

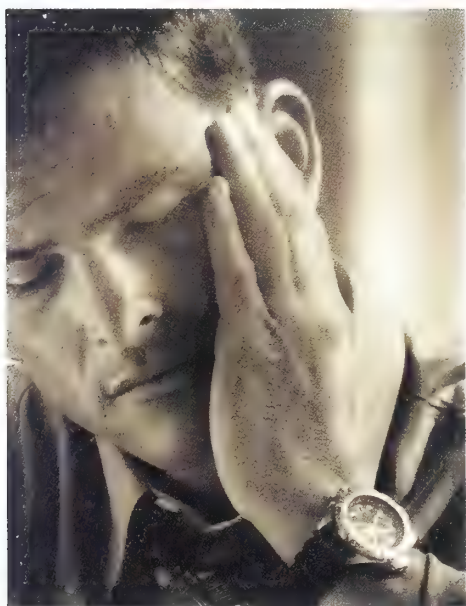
Celey will oversee an expanding empire that includes the new hotel, a museum, and a high-speed ferry service. Pequot Towers, concedes Len Wolman, managing partner in the business group that runs the Mohegan Sun, "will be the top facility in the area." Foxwoods already draws some 45,000 visitors monthly. But the tribe hopes the hotel will attract a more lucrative clientele. "The goal is to expand our market beyond the day-in business," Celey says.

The Mohegans say they're not worried about the Pequot expansion. "We don't anticipate any change in our revenue stream," says Michael Bloom, vice-president of marketing for the tribe. At the Pequot Tower opening, 20,000 people jammed the unfinished casino—twice what Celey expected on a good day. So far, it looks like the Pequot's latest gamble could pay off.

By Susan Jackman in Mashantucket, Conn.



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EDITED BY KELLEY HOLLAND

IP BREAKS OUT THE SCISSORS

FINALLY. INTERNATIONAL PAPER on July 8 announced plans for a restructuring that had been eagerly anticipated ever since John Dillon took over the reins of the company last year. The company will shed \$1 billion in non-core assets and cut 9,000 jobs, or 10% of its workforce, in the process. The moves are expected to trim costs by \$100 million a year and will result in a \$535 million pre-tax charge. But, analysts say, IP still hasn't unveiled its entire restructuring plan. "There were some teeth in this announcement, but it's still not a full mouth," says Kathryn McAuley of Brown Brothers Harriman. "There

is a lot of vagueness in the announcement that Wall Street was not expecting." Still, investors seem to think it's a good start: The announcement drove IP's stock price up 4½%, to 56%.

NEW BIG CHEESES AT McDONALD'S

FALLING ARCHES? IN THE wake of franchisee discontent and its abortive "Campaign 55" discount promotion, McDonald's is reorganizing its U.S. management. Edward Rensi, a 25-year veteran and the chief executive of operations in the U.S.—who was leapfrogged last October by U.S. Chairman Jack Greenberg—is retiring. Five new division presidents who are supposed to be closer to the marketplace will now report to Greenberg. But will the changes boost burger sales? Damon Brundage, an analyst at NatWest Securities, is doubtful: "This is purely cosmetic. The real problem is the food, and U.S. sales won't improve until the food does."

THE TOBACCO DEAL: ASHES TO ASHES?

THE \$368.5 BILLION TOBACCO deal may go up in smoke—unless the cigarette industry agrees to give the Food & Drug Administration more power to regulate nicotine. President Clinton said on July 9 that the June 20 agreement contained a "totally unreasonable restriction" that hampers FDA attempts to control nicotine in cigarettes for 12 years. Capitol Hill may demand concessions, too. But Clinton is optimistic a deal can be reached, despite the controversy about the FDA. "I cannot believe that the tobacco companies or others would bring down the entire settlement over that," Clinton said.

HEADLINER: HERCULES

A 98-POUND WEAKLING?

On-screen, animators have turned him into a hero for the '90s. But Hercules is proving too feeble at the box office to prop up Walt Disney's stock price. Since the press hoopla before the June 27 release of *Hercules*, Disney shares have fallen from 83½ to 78½ on July 8. Other summer blockbusters have overpowered *Hercules*, which generated just \$50.5 million in its first two weeks. Analysts think it could eventually gross \$100 million—but that's a far cry from the \$313 million that *The Lion King* generated in 1994.

Hercules is the latest animation disappointment for Disney, after *Pocahontas* and *The Hunchback of Notre Dame*. That has some wondering whether the animation powerhouse carried the same punch it once did.

Hercules' less-than-muscular showing helped drop Disney's box office market share from June to 13.7%, vs. its usual 20%. But Disney Studio Chairman Joe Roth professes optimism. "We're a little disappointed domestically, but this will still do over \$300 million internationally," he vows.

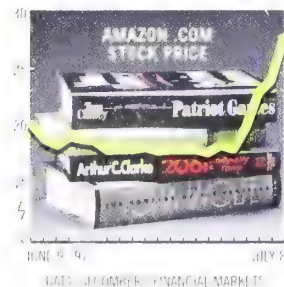
By Ronald Groves



CLOSING BELL

MIGHTY AMAZON

Amazon.com took a giant leap forward in cyberspace when it agreed to pay \$19 million on July 8 to become America Online's bookseller of choice. AOL's 8 million customers will get direct access to the Seattle-based retailer via AOL's home page and Net search service. Similar deals with Yahoo! and Excite will give Amazon prime space on their Web sites in return for fees. Investors cheered the move, lifting Amazon shares 15%, from 24 to 27½—well above its May initial public offering price of \$18.



A MORE REASONABLE FACSIMILE

FREQUENT FAXERS, TAKE heart. UUNET, the Fairfax (Va.)-based Internet service, announced on July 8 a cheaper alternative to faxes transmitted by long-distance calls. Starting this fall, UUNET will offer its 50,000 business customers the option of faxing documents over its Internet service for 20% to 50% less than long-distance carriers charge. UUNET CEO John Sidgmore says he would be delighted to snag just 1% of the telcos' fax business—projected at \$92 billion in 1997. UUNET is putting up 100 fax servers around the world.

TALBOTS GETS HEMMED IN

FASHION VICTIM: EXCESSIVELY short skirts contributed to disastrous summer sales and

a second-quarter profit decline at Talbots, known for its ultraconservative apparel. Talbots' sales shrank by 7.9% in July because its lineup included too many short skirts and other clothes styled for customers younger than the 35-to-55-year-old women Talbots usually targets, CEO Arnold Zetcher. So Talbots will replace its chief merchandising officer—although, of course, it will lower its hem.

ET CETERA...

- Merger consolidation will keep Wells Fargo's of quarterly earnings growth.
- Equitable is expected to name former Chase Securities Vice-Chair Edward Miller as CEO.
- British Airways canceled half its flights from London as attendants walked out.
- Detroit Diesel is buying Outboard Marine for roughly \$500 million, including debt.



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BLACK MONEY

Corporate extortionist? No way. Satoshi Yamamoto prefers to be called a shareholder activist. His small, Tokyo-based publishing company, Rondan Doyukai, invests in companies and publishes stories on corporate misdeeds in a magazine, newsletter, and even a Japanese-language World Wide Web site (www.iiijnet.or.jp/rondan). Insists Yamamoto: "We are professional shareholders."

Yamamoto has not been charged with offenses and maintains his innocence of wrongdoing. But law enforcement officials and criminal attorneys say Rondan Doyukai is actually Japan's biggest ring of *sokaiya*, or mobsters linked to *yakuza* crime syndicates specializing in corporate extortion (BW—July 7). By threatening to disclose unsavory information through magazines or at shareholder meetings, the sources say, Rondan has squeezed payoffs from some of Japan's biggest companies. "Rondan Doyukai is by far the most powerful *sokaiya* group," contends Yoshiaki Shinozaki, a lawyer who advises companies pressured by racketeers.

Yamamoto says Rondan did accept

hush money from companies before the practice was outlawed in 1982. He adds that two Rondan associates were arrested in connection with payoff scandals involving Kirin Brewery Co. in 1993 and Ajinomoto Co., a global food-products maker that pleaded guilty to taking part in a global price-fixing cartel in 1997. Both

companies and the Tokyo Metropolitan Police declined to comment on the case. Yamamoto says one Rondan member was charged with violating the commercial code and released on bail. Another was fined and given a suspended sentence, he says.

■ TOP DKB OFFICIALS BOW IN APOLOGY AT A TOKYO NEWS CONFERENCE AFTER THE ARREST OF FOUR MORE OF THE BANK'S EXECS



THE PAYOFF SCANDALS PLAGUING JAPAN INC.

DATA BUSINESS WEEK

ITO-YOKADO (1992)

President Masatoshi Ito resigns from the big retailer after two executives are charged with making \$236,000 in payoffs.

KIRIN BREWERY (1993)

Chairman Hideyo Motoyama and two other executives at Japan's leading brewery step down after police claim four managers paid \$406,000 to racketeers.

FUJI PHOTO FILM (1994)

After resisting demands for payoffs, managing director is stabbed to death by alleged crime syndicate member.

TAKASHIMAYA (1996)

President Hiroshi Hidaka resigns after four of the upscale retailer's top executives are arrested and charged with forking over \$1.4 million to *sokaiya*.

A rash of scandals is showing how mob-linked investors—the *sokaiya*—prey on some of Japan's biggest companies

other industrialized economy has with corporate blackmail the way it has. But in Japan, *yakuza* racketeers have long been an accepted part of the economy. In a land where there are relatively few attorneys and court drag on for years, mobsters

have been handy for settling everything from highway accident cases to landlord-tenant disputes. In the 1960s, politicians employed gangs to keep left-wing protesters in line. To this day, gang-

given out sparingly and a tight web-of cross-shareholdings among companies leaves individual stockholders out in the cold. But official tolerance of corporate blackmail has been waning ever since the mob began taking a higher profile in the easy-money economy of the late 1980s. Nearly 70% of the 45 big companies responding to a recent poll by the newspaper *Asahi Shimbun* said they had received demands or threats from *sokaiya* racketeers. And for months, the Tokyo stock market has been rocked by disclosures that Ryuichi Koike, who police say is a *sokaiya* member, allegedly extorted \$340 million in loans and millions more in payments and trading profits from Dai-Ichi Kangyo Bank Ltd. and Nomura Securities Co.

FAUSTIAN BARGAIN. Koike, former Nomura President Hideo Sakamaki, and 11 DKB executives, including ex-Chairman Tadashi Okuda, have been arrested and jailed. Former DKB Chairman Kuniji Miyazaki hanged himself on June 29 after police questioned him about his possible involvement in the scandal. Koike

has been charged with violating the commercial code. He has not entered a plea, and his attorney declined a request for an interview. Sakamaki has also been charged with violating the code, while Okuda has not been charged. Neither could be reached for comment.

In addition to the arrests of the executives, the government is moving against their companies. Nomura was charged with violating the Securities & Exchange law; it

says it will try to avoid making payments in the future. And the Ministry of Finance has banned Nomura and DKB from government bond auctions for an indefinite period.

Why the crackdown? Prime Minister Ryutaro Hashimoto is trying to reform Japan's inbred financial markets and



sters are glorified in the media as misunderstood social outcasts, more guardians of samurai traditions than crooks.

Extortion has also thrived because in Japan's corporate culture, public information is

IRA SECURITIES (1997)

o. 1 stockbroker discloses top had dealings with reputed extortionist Ryuichi Koike. ent Hideo Sakamaki and two execs are indicted for giving \$2.8 million to the now-ke. Sakamaki also faces f channeling \$440,000 to allegedly illegal stock trading.

AJINOMOTO (1997)

Two executives are arrested for allegedly giving *sokaiya* \$90,000 to keep them from asking embarrassing questions in public in the wake of the food-product maker's 1996 guilty plea in the U.S. to charges it took part in a cartel that fixed world prices for lysine. Chairman Yasuhiko Yasuda and President Shunsuke Inamori resign.

DAI-ICHI KANGYO BANK (1997)

Prosecutors raid the \$469 billion bank and an affiliate on suspicion that DKB steered \$340 million in loans to a property firm controlled by Ryuichi Koike's brother. Eleven bank executives are arrested. Former DKB Chairman Kuniji Miyazaki hangs himself on June 29 after police question him about the affair.

woo global investors interested in everything from stock trades to making mergers. Figuring investors will be scared away—and that Japan's fits-and-starts economy will suffer—authorities have begun going after the *sokaiya* and the corporations that support them. But for decades, many executives employed *sokaiya* as muscle to keep unruly investors in check during their choreographed annual meetings. "Companies were never interested in paying out dividends, and the *sokaiya* were an effective way of suppressing shareholder dissatisfaction," recalls Manabu Miyazaki, author of *Breakthrough*, a best-selling memoir about his father's *yakuza* gang in Kyoto in the 1950s.

Keeping cash to themselves helped corporations finance capital investment and fuel the nation's postwar recovery. Yet executives' reliance on mobsters turned out to be a Faustian bargain. By the 1970s, the *sokaiya* figured out how to become stockholders themselves and threaten to ask embarrassing questions at annual meetings. Sony Corp. executives still recall what happened when a *sokaiya* group swooped down in 1984. Sony's Betamax standard for videocassette recorders had been floundering. As then-Chairman Akio Morita watched with discomfort, the *sokaiya* turned the annual meeting into a 13½-hour grilling of Sony about its strategy. Sony says it never paid off the *sokaiya*.

EASY PICKINGS. As the stock market took off, three powerful criminal syndicates—the Kobe-based Yamaguchi-gumi and Tokyo's Inagawa-kai and Sumiyoshi-kai—moved into the corporate-blackmail racket. The easy pickings of the bubble economy "really educated the *yakuza*," says Akira Moriuchi, assistant director of the National Police Agency's organized crime division. With land prices soaring, many banks found themselves lending to mob-linked construction companies. Some hired gang members to collect loans or scare reluctant tenants into leaving lucrative properties. After the bubble burst in 1990, some stockbrokers felt obliged to compensate gangland figures through under-the-table deals for losses they had suffered as the stock market declined. These brokers had mob ties stretching back to the 1960s, when companies preparing to list their shares sought out *sokaiya*

protection against nosy investors. Disclosure of their underworld links, the brokers feared, would devastate their reputations.

Such fears are the bread and butter of *sokaiya* blackmailers. Mob pressure on corporate Japan has become so pervasive that, asserts publisher Yamamoto, many large companies maintain budgets for payments to *sokaiya*. Ten percent of the billings at Japan's largest law firm, Mori Sogo, come from advising 100 major listed companies on dealing with *sokaiya*. Hideaki Kubori, a Mori Sogo partner, produces videos on providing security for annual meetings. He even holds mock annual meetings at which he plays the role of a mobster grilling the president.

The uneasy relationship between ex-

He took particular care that shareholders didn't question management too closely about absorbing Kangyo, then Japan's 10th-biggest bank. As early as 1985, says a DKB spokesman, Kijima introduced Ryuichi Koike to senior officials at the merged bank. An attorney familiar with the underworld says Koike described himself as the successor to Kijima, who died in 1993. The attorney says Koike also suggested he had been sponsored by a *yakuza* gang.

"RISKING ONE'S LIFE." In 1988, when DKB was facing questions over \$30 million in dubious loans, Koike helped settle investor queries at an annual meeting. Then, starting in 1992, he began receiving loans, some of which were funneled into a property company owned by

brother. A Nomura spokesman says the funds were ultimately used to buy shares from other brokers. A lawyer for Koike's brother, Yoshinori, declined comment.

After buying 301,000 Nomura shares outright and through his brother's company, prosecutors say, Koike made a move on the bro-



RYUICHI KOIKE

MOVING IN Koike allegedly used Nomura payoffs to buy a big stake in the broker

ecutives and the *sokaiya* is turning Japan's annual meeting season into a circle-the-wagons ritual. This year, more than 2,000 major companies held their annual meetings on June 27 to thwart potential blackmailers interested in raising a ruckus. The government dispatched 10,000 cops to the meetings to provide security. The coordinated meetings have reduced mob disruptions markedly. In fact, the number of *sokaiya* is estimated to have declined to around 1,000, from 1,700 just after corporate payoffs were banned in 1982.

But Moriuchi says mob blackmailers are now demanding—and getting—kickbacks from major companies for steering business to *yakuza*-related waste-hauling, vending-machine, and construction contracts. Executives are also being pressured to purchase costly subscriptions to *sokaiya* publications that are little more than shams.

The latest crop of *sokaiya* scandals shows that extortion can pass from one generation to another. Back before its 1971 merger with Nippon Kangyo Bank Ltd., Dai-Ichi Bank Ltd. had a long-running relationship with legendary *sokaiya* and magazine publisher Rikiya Kijima. For years, Kijima kept the bank's annual meetings short and sweet.

With the stock market slumping and the cost of its European expansion soaring, Nomura announced a record \$60 million loss in 1995. At the same time, it reinstated ex-Chairman Setsuya Tabuchi and ex-President Yoshihisa Tabuchi (a relation) to the company's board. It had been disgraced and forced to resign in a 1991 scandal revolving around helping a mob boss make windfall profits. But they remained powerful behind the scenes. Sakamaki, who has been pushing to clean up Nomura's image, would have been embarrassed by public questions about the Tabuchis and Nomura's ties to Koike. To win Koike's silence during the 1995 annual meeting, prosecutors say, former President Sakamaki approved a \$2.8 million payoff.

Will Japan ever break free of this intrigue? Hashimoto's government promises to come up with tough measures to fight blackmail in legislation next year. But in the end, standing up to the mob "will come down to risking one's life," figures Citizen Watch Chairman Michio Nakajima, who says he has never paid the *sokaiya*. After decades of blackmail, isn't it time for Japan's leaders to fight back?

By Brian Bremner and Eric Thornton in Tokyo

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CHINA

GUANXI IS HIS MIDDLE NAME

The Chinese like U.S. Ambassador Jim Sasser's connections

Between courses of duck and chicken-and-ginseng soup at a June dinner in Beijing, an influential Chinese official perks up at the mention of U.S. Ambassador James R. Sasser. In a refrain now common in Beijing corridors of power, he praises the former Tennessee senator: "He's straightforward and sincere. And he knows Clinton very well."

Human rights, trade frictions, China's defense spending, Donorgate—the sources of friction between Beijing and Washington seem endless. Many Americans regard China with deep suspicion, while the Chinese routinely lash out at America's meddling ways. But in Beijing, policymakers agree on one thing: Jim Sasser is a helluva guy. They don't care that many people in Washington see Sasser as a partisan politician with limited foreign policy experience. Here in Beijing, the 60-year-old diplomat is something else: a peacemaker and the man who can interpret America's byzantine foreign policy practices to Beijing's often-bewildered cadres. Says Sasser: "I'm out here

trying to explain how we do things."

Sasser's approach has been to work his Beltway connections for all they're worth. Since taking his post in early 1996, he has been returning to Washington every two to three months to press for more U.S.-China contacts. As a result, Secretary of State Madeleine K. Al-

"STRAIGHTFORWARD" To Beijing, the diplomat is a peacemaker and the man who can help them make sense of America's often-bewildering foreign policy practices

bright, Vice-President Al Gore, and Federal Reserve Chairman Alan Greenspan, as well as one in five members of the House of Representatives, have all visited Beijing this year. Similarly, Chinese officials such as foreign minister Qian Qichen and Defense Minister General Chi Haotian have been through Washington.

In a surprising display of accessibility, Beijing's top leaders have been meeting with almost every American visitor, right down to the lowliest junior congressional representative in town. That's a result

OPENING A CAR PLANT: Sasser (left) "really takes business seriously"

of Sasser's efforts to convince Beijing of the importance of Congress and of how it can hold China policy hostage. "[The Chinese leadership] has learned a lot about how America works recently," says J. Holden, chairman of the American Chamber of Commerce in Beijing.

PUSHOVER? The local U.S. business community is especially grateful to Sasser. He regularly passes business concerns on to the Chinese ministries and even visits far-flung provinces to promote American interests. Earlier this year, he successfully pressed foreign minister Qian and executives at Air China to buy Boeing 777 jetliners.

What's dogging Sasser is his reputation as a pushover at home. The Chinese like Sasser because "they figure he's nice and he's weak. He won't cause problems," says one former U.S. administration official. And many still view Sasser as simply a political appointee.

Sasser defends his approach: "I don't think it's the role of any ambassador to gratuitously offend the country he is representing." And he feels he leans on the Chinese when necessary. In a speech earlier this summer, he warned the Chinese to watch their step during the important period of Hong Kong's handover. And he brushes off the Beltway critics that he's nothing but a politician. "China welcomed a political appointee," he says. "They were pleased to get someone who could communicate their views directly to the Administration."

One danger with Sasser's approach is that with *guanxi*, or connections—which are often seen as all-important in China—his own reliance on contacts back home could backfire. By overemphasizing Sasser's role in the overall relationship, China may feel safe in ignoring many demands coming out of Washington.

Meanwhile, Sasser's biggest test is coming, as the hearings on Donorgate get under way in Washington. "I don't think these hearings will make things any easier for us," says Sasser, who for now is skeptical that solid evidence will emerge of direct Chinese efforts to influence U.S. elections. But even if Donorgate produces a diplomatic fracas, Sasser will keep trying to smooth the way, using all the tricks he learned from 18 years of Capitol politics.

By Dexter Roberts in Beijing, with Steve Crock and Amy Borrus in Washington



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COMMENTARY

By Stanley Reed

TONY'S SECRET WEAPON: BILL'S EXPERIENCE

During his election campaign, British Prime Minister Tony Blair often heard himself compared to President Bill Clinton. People called him a Clinton clone, or Clinton Lite. But paying close attention to his U.S. counterpart is proving to be a clever strategy for Blair. After 10 weeks in office, his popularity rating is a record 72%.

The two Anglo-Saxon leaders have some built-in similarities. Both rode to office on a wave of voter ennui after many years of conservative government. Both capitalized on their youth and personal charisma. And both reshaped their parties' plat-

form off course. Distracting battles over gays in the military, personal scandals, and controversial Cabinet appointments damaged his credibility. Meanwhile, his massive health-care reform plan scared away business supporters and finally collapsed.

A HOT ECONOMY. Blair seems to be making sure he doesn't swerve from his focus on economic growth. He won applause after just four days in office by ending government influence over the Bank of England on interest-rate policy. Cutting top corporate tax rates from 33% to 31% in the recent budget also came as a pleasant surprise. And executives approve of

Treasury Secretary Lawrence H. Summers, another adviser to Labour.

Blair and Brown listened carefully. They inherited a hot economy from the Tories, with growth expected to approach 4% this year and inflation creeping to 2.7%. So Blair hopes that an interest-rate hike from the newly independent central bank, plus tight fiscal policy, will cool the economy and burnish his reputation even further.

The no-nonsense budget unveiled on July 2 could also be an inflation-buster. It will raise a net \$9 billion through tax increases. Economists think Brown achieved his main goal of keeping long-term interest rates—now 6.75%—from surging into the 9% or 10% range.

To be sure, challenges will arise to distract Blair. The three-day strike by British Airways PLC flight attendants that began on July 9, for instance, is a potential minefield. Blair could find himself caught in the crossfire between a friendly captain of industry, BA Chief Executive Robert Ayling, and the Transport & General Workers Union, a major Labour backer.

But Blair is unlikely to let such controversies grow into major obstacles

to his overriding economic agenda. And he benefits enormously by not having to contend with a hostile legislature. By definition, Britain's Prime Minister is majority leader of Parliament. With his 179-seat majority, Blair enjoys near-dictatorial powers. That has already let him do things Clinton could never dream of. For example, Blair passed a bill banning large-caliber handguns and earmarked \$300 million to compensate owners for turning them in.

Blair is sure to continue looking across the Atlantic for ideas. And if he keeps up his early pace, Clinton may start taking cues from London as well.

Reed manages Business Week's London bureau.



Clinton was distracted almost immediately. Blair is keeping his focus where it ought to be

forms with pro-growth, pro-business agendas. But Blair had one big advantage—the chance to study Clinton's failures and successes. That has allowed him to avoid the embarrassing mistakes that dogged Clinton's first term and led to the Republicans' congressional sweep in 1994. It has also let Blair learn valuable lessons from the playbook that has made the U.S. economy the world's strongest.

When Clinton first came to the White House, Corporate America welcomed his focus on the economy. He broke the Democratic Party mold by emphasizing deficit cuts, free-trade pacts, and streamlined government. But a mix of policy and public-relations blunders knocked Clinton

THINKING ALIKE
Blair is hoping to cool growth and keep inflation tame

the election, his designated Chancellor of the Exchequer, Gordon Brown, went to Washington for skull sessions with U.S. Treasury Secretary Robert E. Rubin and Federal Reserve Board Chairman Alan Greenspan. The Americans advised him that Britain couldn't boost business investment without lower interest rates—and rates wouldn't fall unless Labour remained vigilant against inflation. They urged Brown to follow the U.S. example. "Clintonomics is a good U.S. export, because it has worked," says Deputy

Blair's plans to boost education and training.

In fact, Blair's main goal is to duplicate America's long-running expansion. So before

EDITED BY JOHN TEMPLEMAN

MEXICO: NOW THE RULING PARTY WILL CRUMBLE EVEN FASTER

Mexican voters broke the Institutional Revolutionary Party's (PRI) seven-decade lock on power in a political earthquake on July 6. By splitting control of Congress between three parties and handing two governorships and the mayoralty of Mexico City to opponents at mid-term elections, they projected Mexico into a new, fractious policy era. For the first time ever, two opposition parties, the leftist Party of the Democratic Revolution (PRD) and the center-right National Action Party (PAN), have a fighting chance of winning presidential elections, next due in 2000. By wielding their new, mostly urban power, they will expedite the crumbling of the monolithic PRI state and its tightly controlled economy. Opponents have the clout to challenge policies once rammed through without concessions.

The main battle zone will be the lower house of Congress. With the loss of the majority there, President Ernesto Zedillo Ponce de León will have to forge compromises to pass legislation. He'll face stiff resistance from the opposition over the next year. There may be bitter fights if the PRI tries to stymie opposition efforts to end years of PRI graft. And pressure will mount to revise parts of the North American Free Trade Agreement seen as being unfairly applied, such as access to the U.S. by Mexican trucks.

BLOOD. Opposition leaders are out to prove they can win. PRD leader Cuauhtémoc Cárdenas Solórzano, 63, who was Mexico City's first elected mayor, for instance, wants to reinvigorate the capital with low-cost housing, better mass transit, and a cultural revival. Former Coca-Cola Co. executive Victor Fox, with a shoot-from-the-hip style, is the PAN's most charismatic figure. And now that one in three Mexicans lives in a city or state controlled by PAN, governors such as Fox will have the clout to push for clean government and job creation. Some analysts, erosion of the old PRI state will bring pol-

icy gridlock. Others, though, see Mexico's easy transition from arrogant autocracy to rambunctious democracy as a big plus. "This political transformation will have a very positive influence on the economy," says Juan Sánchez Navarro, vice-president of brewer Grupo Modelo.

The stock market soared after the election, and economists are betting that \$8 billion in stalled investments will now go ahead. "People's irrational fears about what this political transition was going to look like" had stunted foreign investment, says Chip Brown, economist at Morgan Stanley Dean Witter Discover & Co. in New York. Deregulation and

a more open market could pump those trends. With PAN support, technocrats may be able to further open banking and the natural gas industry to foreigners.

BLOWOUT? Indeed, with the economy expected to surge 5% this year, euphoria could be the danger as Mexico's new democracy flexes its muscles. For the first time since the December, 1994, peso devaluation, consumer spending and industrial wages are picking up. Even so, the PRD is likely to push for more social spending, wage hikes, and a cut in the 15% value-added tax to bolster consumption, while

PAN wants lower corporate taxes to help small business.

Zedillo, of course, wants to keep a lid on the economy to prevent a blowout. His officials want to limit wage increases to avoid sharp consumption binges that worsen the trade balance. But even that won't be a snap any more. The election-eve death of veteran union boss Fidel Velázquez robbed the PRI of much of its sway over organized labor.

Workers were starting to tune out strongmen like Velázquez anyway. Now, even disillusioned PRI troops in Congress seem determined to stop being rubber stamps. The decline of the PRI state, often corrupt and incompetent, seems well under way.

By Geri Smith in Mexico City



AFTER THE VOTE: Optimism soars

GLOBAL WRAPUP

HONG KONG WAGES RISE

Hong Kong workers used to dream of earning U.S.-size pay packages. No longer. Salaries in Hong Kong are among the highest in the world, according to a survey by management consultants Watson Wyatt Worldwide. A sales manager, for instance, earns a hefty \$105,400 there, compared with \$73,400 in the U.S. The gap with mainland China is even wider. The same sales manager in Shanghai rakes in just \$23,300. China's economic boom, high inflation,

and strong demand for skilled workers have pumped up Hong Kong salaries 30% over the last three years. Although mainland workers are far less productive than those in Hong Kong and are starting from a lower base, they're catching up. Over the same three-year period, their salaries soared 92%.

TURKEY SETS REFORM GOALS

► Turkey's new secular government is promising early elections next year, but Prime Minister Mesut Yilmaz is not in caretaker mode. On July 7, the leader of the Motherland Party

announced measures to speed privatization, curb budget deficits, and restructure the bankrupt social security system. His top priority is to slash the country's 76% inflation rate.

Yilmaz' plans fueled gains in the Istanbul Stock Exchange, up 22% since June 18, when Turkey's military forced Necmettin Erbakan, leader of the Islamist Welfare Party, to resign. With backing from his coalition partners—the Democratic Left Party and the Democratic Turkey Party—and votes from smaller parties, Yilmaz is expected to win a vote of confidence on July 12.



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WHAT'S BETTER THAN A PRIVATE PLANE? A SEMIPRIVATE PLANE

Rich Santulli's Executive Jet is booming by selling fractional interests and service



Richard T. Santulli has more private jets at his disposal than anyone in the world—100, at last count—yet he travels as seldom as possible. It's not that he doesn't like to fly. He just isn't comfortable wandering far from his corner office at Executive Jet Aviation Inc. (EJA) in Montvale, N.J. The company's success has made Santulli, a mathematics professor turned entrepreneur, a wealthy and very busy man. "I guarantee you I get more urgent calls on Sunday night than any doctor in America," says Santulli, chief executive officer and majority owner of EJA.

In commercializing the idea of selling private jets in one-eighth and one-quarter shares, Santulli has lifted the fortunes of his own company, and those of the entire small-jet industry, to new heights. "Rich Santulli is truly a pioneer," says Arthur E. Wegner, CEO of Raytheon Aircraft Co., one of EJA's principal suppliers and its newest rival. "He demonstrated tremendous vision."

"I guarantee you I get more urgent calls on Sunday night than any doctor in America"

RICHARD SANTULLI

Chairman, Executive Jet Aviation

Nearly bankrupt in the early 1990s, privately held EJA booked revenues in excess of \$500 million in the fiscal year ended Apr. 30, up from \$65 million in 1992. Over the past two years, the company has placed \$2 billion in orders, making it the biggest customer of each of the three leading U.S. business-jet manufacturers: Raytheon, Cessna Aircraft, and Gulfstream Aerospace. So successful is Santulli's innovative scheme that next month Raytheon will launch a subsidiary to do battle with him in the emerging "fractional" market. Raytheon predicts that the total number of planes

sold fractionally will quadruple by 2000.

EJA's fractional shares program, dubbed NetJets—is broadening the market for private jets by selling them at a fraction of the prices offered by manufacturers. Obviously, many more owners can afford \$389,000 for a one-tenth share of EJA's lowest-model—the Citation 5 Ultra—than could afford to pay \$6 million or so to buy the whole plane direct from Cessna.

But the real beauty of NetJets is that fractional owners don't have to fly on their turn or put up with group travel. Their planes stay with EJA, which operates them—for a fee, of course. The company guarantees fractional owners that it will make a plane available on four to six hours notice at any one of 5,000 airports. This is only possible because EJA maintains a "core fleet" of planes that it owns and makes available to NetJets customers as needed.

Relying mainly on referrals, Santulli has built a roster of 700 fractional owners. About 70% of them are companies.



THE LIFEBOOK

600

*The first-day-of-spring,
not-a-care-in-the-world,*

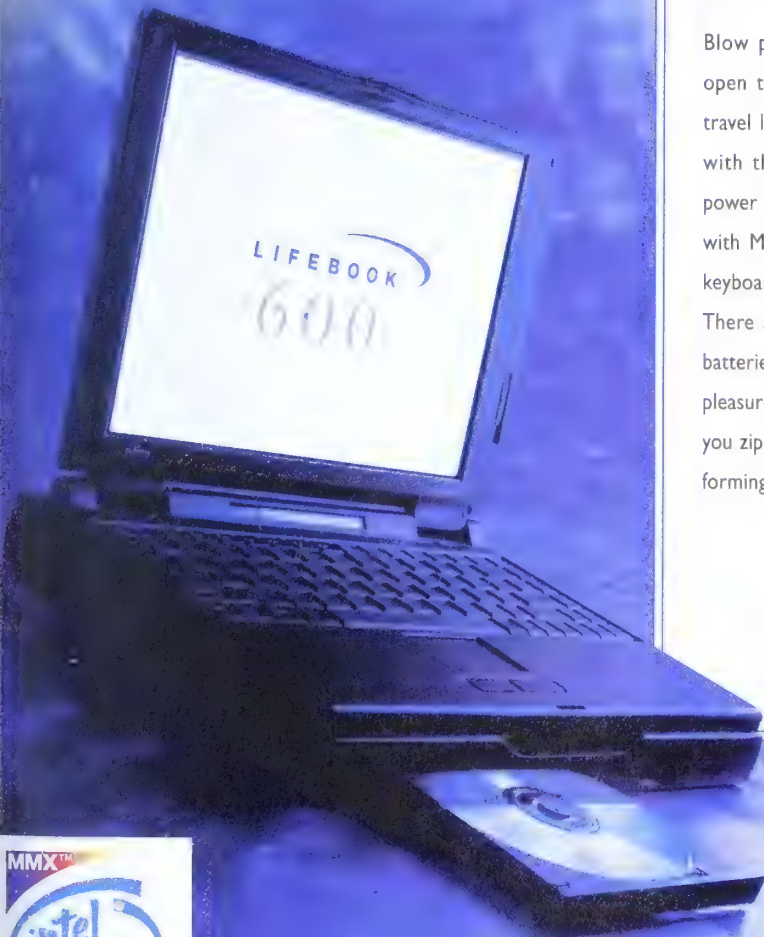
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THE RAIN
DOESN'T KNOW
WHAT KIND OF



DRIVER YOU ARE.

It doesn't know if
you're driving alone
or with your family.
It doesn't know if
you're driving a minivan
or a sports car.

We happen to make both –
and a lot of other
vehicles as well.

The last we looked,
weather happens
to all of them.

So we try to make
them all safe no matter
what the weather.

You can count on every
GM car and truck,
wherever life takes you.

*GM vehicles
with over
100 standard
safety features:*

All

*GM vehicles
with Rainsense™
automatic
wiper system
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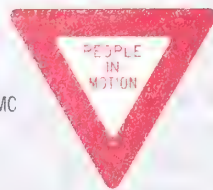
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but NetJets recently has attracted a flying parade of celebrities. Tiger Woods bought a one-eighth share of a Citation 10 after his Masters victory. Don Imus picked up a quarter-share in a Gulfstream IV last fall and has been working EJA into his radio show ever since. But perhaps the most striking testimonial has come from Pete Sampras, who owns a one-eighth share in a Hawker 1000 and expects the sheer convenience of NetJets to extend his playing career by a year or two. "Buying a plane was one of the best decisions I ever made," Sampras says.

GALLOPING PASSION. Although Santulli goes to great lengths to accommodate the special travel needs of all his customers, making himself available by telephone 24 hours a day, he keeps his distance socially. Hobnobbing with the rich and famous is just not his style, he says: "The people I deal with in this business are a Who's Who in America. But my parish priest is as much of a celebrity to me as Don Imus."

For all his devotion to EJA, Santulli has no great affection for airplanes. "I'm not a plane nut," he says. "Horses are my passion." Santulli has ridden since he was a boy, galloping around Brooklyn's Prospect Park with his brother on rented steeds. In 1982, he co-founded Jayeff Stables, a Kentucky-based commercial breeder that keeps a half-dozen racehorses stabled near Santulli's New Jersey home. Most workdays, EJA's chief rises at six and spends an hour or two watching his "babies" go through their paces before heading to the office.

The son of a federal government worker, Santulli was raised in a working-class Italian neighborhood in Brooklyn. He sailed through Catholic school and enrolled at Polytechnic University of New York, where he majored in applied mathematics. After earning a BS and two MS degrees, he moved on to the math faculty while working on his PhD. "I loved the freedom of math," says Santulli, who left Polytech when the birth of his son in 1967 forced him "to get a real job."

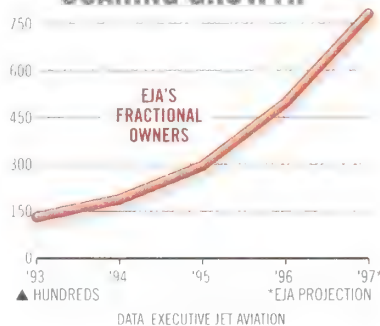
After a stint at Shell Oil Co., Santulli landed into a job at Goldman, Sachs & Co., which was perhaps the first major Wall Street house to begin applying

BAD TIMES EJA flirted with disaster in the 1990 recession, but Santulli kept the company going by personally guaranteeing \$125 million in bank loans

computer-based modeling to investment banking. As an early "quant," Santulli wrote the first programs for many of Goldman's specialized finance groups and proved himself as adept at making deals as crunching numbers. He resigned from Goldman, Sachs in 1979 despite assurances that he would have been named a partner the next year. "At times in my life, I was insecure," he explains. "Was Goldman making me good at what I did, or was I really good?"

Santulli founded his own transportation leasing company, RTS Capital Services Inc., which soon became the leading helicopter lessor in the country. In 1984, he branched out by acquiring Executive Jet Aviation, a charter business based in Columbus, Ohio. EJA was running at a loss, but its assets included a first-class reputation and a colorful history.

EXECUTIVE JET'S SOARING GROWTH



Founded in 1964 by a group of retired U.S. Air Force generals, EJA's board included actor Jimmy Stewart and entertainer Arthur Godfrey, proficient pilots both. Paul W. Tibbets Jr., the pilot who dropped the

atomic bomb on Hiroshima, was the president.

While pondering ways to energize EJA, Santulli hit upon the idea of fractional ownership. Fortunately, the military minds at EJA had kept records of every trip the company had ever flown. Santulli pulled the records for four different years and was delighted to find a high degree of predictability in terms of destination and length of stay. It took him nearly five months to work out the mathematical underpinnings of NetJets and reconcile the seemingly contradictory features of fractional ownership and guaranteed access.

Santulli launched NetJets in 1986, shelling out \$4 million as a down payment on eight Cessna Citation IIs and

hiring dozens of pilots, dispatchers, other employees to ensure high-quality service from the start. However, Santulli's powers of persuasion were tested as never before when corporate finance department managers accused him of plotting to usurp their jobs, and plane manufacturers of trying to cheat their customers. EJA's own charter customers were skeptical that NetJets would work as advertised.

To get NetJets airborne, Santulli had to offer prospective owners a more than break-even guarantee. EJA was just near the break-even point when the economy tumbled into the 1990 recession. Santulli kept the company afloat with borrowed funds, putting everything he owned—and more—in his personally guaranteeing \$125 million in bank loans. "If the company went bankrupt, I had no right to have any money," he says. The sale of fractional shares picked up smartly in 1993 as EJA broadened its product line to include larger planes. The company was breaking even in 1994 and then soared into the black.

GROWING PAINS. EJA did not have a major competitor until mid-1995, when Montreal-based jetmaker Bombardier Inc. joined forces with AMR Combs and the charter affiliate of American Airlines Inc., to found Business Jet Solutions, based in Dallas. And beginning in August, Raytheon's new subsidiary will go head to head with EJA in selling the new Hawker 800 XP. Santulli says that he welcomes Raytheon's entry, which confirms the validity of our product.

By all accounts, the challenge for Santulli is not competing for customers but managing EJA's growth. Before accepting a 25% stake last year, Goldman, Sachs had to convince itself that EJA was not a one-man company. "Most people don't have the ability or the propensity to do it all by themselves, but he does," says Charles A. Davis, a Goldman limited partner. In Davis' estimation, Santulli has learned to delegate to his strong management team he has assembled. Still, it was just a few months ago that EJA's chief finally agreed to stop bringing his cellular phone to the golf course. Now, if someone calls, only get Santulli to take his phone off the hook on Sunday night.

By Anthony Bianco
Montvale, N.J.

AN JANE GARVEY PULL THE FAA OUT OF ITS DIVE?

Clinton's choice as chief is short on experience. Does it matter?

When President Clinton tapped Jane F. Garvey to take over the Federal Aviation Administration, whispering began. Her predecessor, former airline exec David R. Hinson, Mr. Insider in the aviation world. Garvey, acting administrator of the Federal Highway Administration, would only be Ms. Outsider. For one thing, she doesn't fly. That would make her the third FAA chief in history without a pilot's license.

But the questions run deeper. If Garvey, who will preside over an agency whose military mind-set and pro-industry sympathies have frustrated previous modernization efforts, "They [the FAA bureaucracy] try to eat her alive," says one former Transportation Dept. official. Still, Garvey—who declined to talk with BUSINESS WEEK until after it was confirmed—is set for takeoff. On June 24, she weathered sharp questioning from a Senate panel and is likely to be approved by August for a five-year stint. "Garvey will," says Senator John McCain (R-Ariz.), chairman of the Commerce Committee. "But I have significant reservations about her ability to do the job." And even Democrats seemed divided in their support. "It's not so easy to figure out the direction to take," Ernest F. Hollings (D-S.C.), ranking minority member on Commerce, told Garvey, "but it is extremely difficult to get there."

ADY CLIMB. Garvey, 53, got her start in politics as an organizer for Michael Dukakis' 1982 bid for the Massachusetts governorship. In 1983, former English teacher and wife of Hampshire County Sheriff Robert Garvey was named associate commissioner of the Massachusetts Public Safety Dept. Six years later, she became commissioner. She ran Boston's Logan International Airport for two years, from 1991 to 1993, before being the No. 2 official at the FAA. There, Garvey worked for Clinton's longtime Arkansas buddy, Transportation Secretary Rodney E.

Slater. It was Slater, insiders say, who pushed Clinton to tap Garvey for the FAA post. "That place is a snake pit," says one FAA official. "Slater needed someone he could trust."

While Slater can surely trust her as a political ally, GOP critics on the Hill wonder whether he can rely on her to handle a nearly \$9 billion budget. They point to Garvey's oversight of Boston's Central Artery and Ted Williams Tunnel—a construction project that soared

TROUBLE BEHIND. TROUBLE AHEAD?

The FAA struggles as air travel grows

May 1996 A ValuJet DC-9 crashes in the Everglades, killing 110 aboard. After initially defending the airline, the FAA does an about-face: It grounds ValuJet and sacks a top safety official.



July 1996 Mary Schiavo abruptly quits as Transportation Dept. inspector general. She writes a blistering book that finds the FAA "incompetent at virtually all of its inspection responsibilities."

November 1996

Former airline executive David R. Hinson resigns after three years as Federal Aviation Administrator.



January 1997 The FAA launches a \$2 billion-a-year effort to upgrade the long-neglected air-traffic-control system, which has logged hundreds of hours of breakdowns in recent years.



June 1997 President Clinton nominates Jane Garvey, a relative novice in aviation, as the first woman to head the agency.

DATA: BUSINESS WEEK

from an estimate of \$2.5 billion in 1985 to \$10.5 billion today. "At any point, did you say: 'Wait a minute—this cost is getting out of control?'" asked McCain at the nomination hearing. Replied Garvey: "It was a change in scope, the inflation costs, and some changes through construction and design."

In Massachusetts, Garvey is not blamed for the overruns, but her answer troubles Mary Schiavo, the former Transportation Dept. inspector general who quit last year to protest lax standards at the FAA. Says Schiavo, whose book *Flying Safe, Flying Blind* has made her one of the agency's harshest critics: "At FAA, she and Slater couldn't manage big projects. I fear that will be a problem again."

WAKE-UP CALLS. And the FAA problems are legion. For one, agency boosters and critics agree that the air-traffic-control system needs an overhaul. Yet as commuter and regional flights crowd into

commercial airspace, the FAA's efforts at modernization remain largely unsuccessful. Agency officials have relied heavily on industry views in making crucial safety decisions. And some safety experts complain that the FAA acts only after tragedies, such as the ValuJet DC-9 crash in the Everglades and the Trans World Airline Flight 800 disaster off Long Island.

That assessment may be harsh, but few would deny that the FAA is falling further and further behind the curve. While the agency's budget is set to rise a total of only 15% over the next five years, it projects passenger growth of 35% over the same period. At the current rate of airline mishaps, aviation experts project a major accident somewhere in the world each week by 2015. "The challenge is how to do more with less," says Senator Wendell H. Ford of Kentucky, top Democrat on the aviation subcommittee.

Garvey is up to that challenge, insist supporters such as J. Randolph Babbitt, president of the Air Line Pilots Association International. "If we were talking about her in the abstract, yes, her résumé and qualifications would be a concern. But Logan is a tough airport to run, and she did a great job. She has terrific management skills," says Babbitt. Even some industry leaders welcome her charming yet no-nonsense style. Garvey "is no cream puff," says one. She had better not be. And she probably ought to invest in a sturdy seat belt.

By Mary Beth Regan in Washington, with Geoffrey Smith in Boston



How To RETIRE SUCCESSFULLY

Today's workers must cover more of the costs themselves. But they have new tools for the job

Lately, we are working harder and longer—and surrendering more in taxes—yet are still lamenting that we'll never retire as comfortably as our parents. With fewer workers supporting a larger cohort of elderly dependents, Social Security is unsustainable, and Medicare costs are out of control. Despite a lifetime of paying for both, most of us are unlikely to receive our full share of either.

Guaranteed pensions and retiree medical coverage are becoming obsolete. Personal savings are at a record low. The message is constant and comes from all corners—economists, investment advisers, politicians, and the press: "Retire-

SPECIAL REPORT

INVESTMENT STRATEGIES • 62

LIVING IT UP • 70

WHERE TO LIVE • 70

GENERATION X • 76

TODAY'S LIFESTYLES • 78

SANDWICH GENERATION • 84

AVOIDING RIPOFFS • 85

PLANNING BY PC • 88

LIFE AFTER WORK • 92

ment is a luxury only the rich can afford." Meanwhile, the rest of us fret that we'll be spending our golden years flipping burgers at the golden arches.

But just because a guaranteed safety net no longer exists does not mean that we will free-fall into old age impoverished and infirm. A financially secure retirement is still within reach if you're willing to maximize the numerous savings and investment opportunities available, and ad-

just your expectations.

To be sure, today's workers must cover more of the cost of retirement themselves. But the baby-boom generation has several advantages that current retirees did not. Baby boomers have big-

ger incomes, greater pension entitlement, and higher net worth than their parents and grandparents did at comparable ages, according to the Employee Benefits Research Institute (EBRI) in Washington. For much of the past decade, many boomers have climbed

RETIREMENT GUIDE

aboard a raging bull on Wall Street, leaving many of them with far greater nest eggs than they expected. And employment rates are up for women, thus boosting their pension coverage, sug-

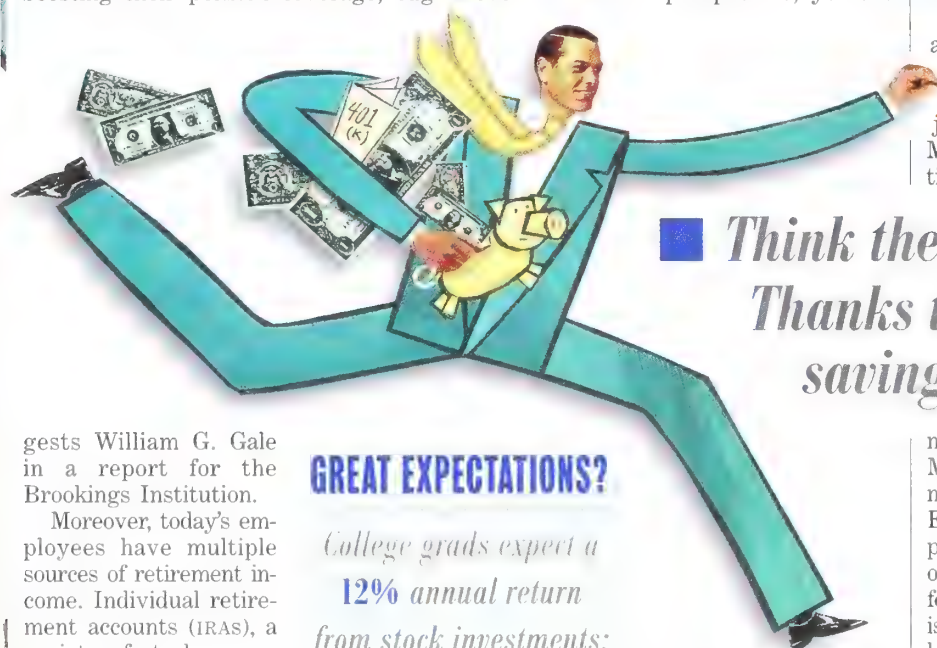
able to maintain their current standard of living in retirement.

What's more, when you add in the money invested in equities, the situation seems even less dire. Since the personal savings rate measures only the share of income not spent, it does not give a completely accurate picture of Americans' financial well-being. It ignores the paper profits that employees hold in stocks and stock mutual funds and the ultimately positive effect that capital-gains buildup has had upon many people's net worth. "You have a situation where workers are saving more than ever from their perspective, yet the

ing Social Security is not the number of older people but the cost and level of their medical care, says Sandra Reynolds, an assistant professor of gerontology at the University of South Florida in Tampa.

ADDED BENEFITS. Since few employers offer retirees medical insurance, most rely on Medicare, the taxpayer-funded insurance program for the elderly and disabled. By the time today's workers retire, the financially troubled Medicare system will look very different. Not only is the eligibility age likely to be raised to 67, but richer seniors may also ultimately pay higher premiums.

The good news is, future retirees may actually receive more benefits—such as coverage for prescription drugs, vision and hearing tests—for less money by joining one of the growing number of Medicare health maintenance organizations (HMOs). Their signing-on will also



gests William G. Gale in a report for the Brookings Institution.

Moreover, today's employees have multiple sources of retirement income. Individual retirement accounts (IRAs), a variety of stock-ownership programs, and insurance provide benefits unavailable to workers of yesteryear. Folks are investing smarter and earlier. Retirement planning no longer takes place in the employee cafeteria at age 64, says Jerry Potts, marketing director for MFS Funds in Boston. "Now, companies are offering much younger employees a wide range of educational and financial-planning services."

EMPTY PIGGY BANKS. Even though baby boomers are more knowledgeable about saving and investing and can use a wide array of vehicles to manage their assets, the personal savings rate has declined from more than 7% throughout the 1960s to just under 5% in 1996. But the savings crisis may be overstated. In a study for Merrill Lynch & Co., Stanford University economist Douglas B. Bernheim found that excluding the equity in their houses, baby boomers were saving only about one-third of what they will need in retirement. Yet when housing wealth is included, more than two-thirds of boomers likely will be

GREAT EXPECTATIONS?

*College grads expect a
12% annual return
from stock investments;
high school dropouts
predict 29%*

savings rate is low," says EBRI President Dallas L. Salisbury.

Similarly, the oft-predicted collapse of Social Security is not quite as cut and dried—nor as catastrophic—as it appears. According to economic forecasts, the Social Security trust fund will be exhausted by 2029 unless benefits are reduced or taxes increased. Yet this shortfall is predicated on assumptions of slower economic growth than the U.S. has enjoyed for the past several years. In contrast, higher productivity resulting from efficient use of information technology means greater wealth, which should make funding Social Security easier.

Doomsayers contend that even an exceptionally strong economy will not be enough to offset the anticipated age wave. But in fact, the greatest challenge fac-

**Think the shrinking safety net.
Thanks to a robust economy
and savings plans, you've got**

negate the expense of supplemental Medigap insurance policies, which cover most of the hefty fees Medicare won't pay. Enrollment will be optional, and participants maintain the right to switch back on a monthly basis into the traditional fee-for-service Medicare system if dissatisfied. Since these HMOs are still relatively new, patients may not be able to pick a doctor they like, and facilities may be limited. But as competition intensifies, Medicare HMOs will develop stronger regional networks with improved coverage and service, figures Henry S. Moyer, partner at the employee-benefits consulting firm of Hirschfeld, Stern, Moyer & Ross in New York.

With life expectancies on the rise, however, the biggest threat to retirement savings will be the cost of long-term care. Since Medicare offers only limited nursing-home coverage, most and more young employees are planning ahead and buying long-term-care insurance policies on their own through the handful of employers—such as IBM, Alamo Car Rental, and Wells Fargo—that offer a group plan.

Until recently, the policies, which foot the bill for a variety of services ranging from home health care to nursing

FRAYED NET

*The average respondent
who attended some
college believes only
20% of his retirement
income will come from
Social Security*

mes, were expensive and often underwritten by financially troubled insurers. Today, policies are more affordable and available from solvent companies [such as Travelers, UNUM, and John Hancock]," says Potts of MFS. As of this year, employers and individual buyers may be able to deduct some or all of long-term-care premiums and expenses from their federal income taxes. The tax break will dramatically increase the number of companies that offer coverage, predicts William Steinberg, consultant at Hirschfeld, Stern, Moyer & Moss. In the meantime, insurers are coming up with novel options for people who do not have

Another fallacy is this: Because fewer folks have access to defined benefit plans—which guarantee a fixed annuity for life—their chances of retiring comfortably will be reduced. Yet prior to the passage of the Employee Retirement Income Security Act (ERISA) in 1974, workers who left a company before age 65—regardless of their years of service—often forfeited their pension entirely. As a result, 20 years ago only 50% of defined-benefit-plan participants actually received any money, Salisbury says. Today, thanks to reduced vesting requirements and pension portability, that number has climbed to 85%.

shifting all your assets into bonds near retirement. Financial advisers are recommending that 60- to 70-year-old investors allocate as much as 25% to equities, says David J. Castellani, senior vice-president at CIGNA Retirement & Investment Services in Hartford.

CATCH-UP. An extended bull market has increased assets in 401(k) plans—at a compounded annual rate of 18% over the past decade—to around \$810 billion, according to Access Research Inc. in Windsor, Conn. Participation among employees who were eligible to contribute to their company's 401(k) plan rose from 64% in 1986 to 78% in 1996, Access reports. Those numbers are likely to grow if a proposal in Congress becomes law, allowing workers who take extended leave due to illness or childbirth to make catch-up contributions to their retirement plan.

Future retirees will also benefit from stock ownership incentives such as stock

ins you'll be impoverished in your old age? Think again. Coming market, and an abundance of investment and a better shot at a comfortable retirement than your parents

cess to a group long-term-care insurance plan. For example, a long-term disability policy from UNUM converts to long-term-care insurance once the policyholder enters retirement. But what makes the insurance additionally appealing is that you won't need to provide evidence of insurability, and the policy is portable if you change jobs.

DEAD DAYS. In spite of an abundance of employee benefits and more flexible and affordable insurance coverage, many Americans still pine for the way things used to be. But they miss the point. Even given the possibility that Social Security and Medicare benefits will be reduced and that individual contributions will be increased, the government's role in retirement is overemphasized. "Americans fixate on Social Security's stability, and they forget that it was never intended to be the sole source of retirement income," says Neal

Cutler, professor of financial gerontology at Drexel University in Philadelphia, Pa. Even so, 6 out of 10 current retirees use it as such. Part of the problem is that people mistakenly assume that Social Security provides an adequate retirement income," says EBRI's Salisbury. "The reality is, it never did."

AN EDUCATED SAVER

37% of college grads save at least 10% of their incomes for retirement, but 22% of those with some college haven't invested or saved for retirement at all

Even if the only retirement plan that your company offers is a defined-contribution or 401(k) plan, you may be better off than you think. Unlike traditional pensions, which pay investors a fixed return regardless of market performance, defined-contribution plans let you control the risk and reward, says Ward Armstrong, president of American Express Retirement Services in Minneapolis.

Encouraged by strong stock market performance, employees of all ages are shifting more of their retirement-plan assets into equities, says Mary Rudie Barnaby, president of the National Defined Contribution Council, an association of 401(k) plan providers. In the 401(k) plans administered by American Express, there has been a dramatic shift toward stocks: In 1987, 65% of assets were allocated to fixed income and 35% to equity. Ten years later, that ratio has been reversed. Today's longer life expectancies even challenge the wisdom of

HOME SWEET HOME

67% of those age 30 to 39 cite hefty housing expenses as an obstacle to their saving for retirement

Survey of 1,026 adults conducted June 11-17, 1997, for BUSINESS WEEK by Louis Harris & Associates Inc.

option and employee stock ownership plans (ESOPs). Today, there are an estimated 10,000 ESOPs, a fivefold increase in the past 20 years, reports the ESOP Assn. in Washington. "Giving employees a few hundred shares of stock here and there over time adds up to a significant cash benefit," says Castellani. Just ask employees at Lowe's Cos., a large chain of home-improvement centers in North

Wilkesboro, N.C. The company makes additional contributions of up to 17% of employees' gross income in Lowe's stock to their employee stock ownership accounts. Many lower-level employees—including janitors—have retired with six-figure accounts, says CEO Bob Tillman.

Indeed, preparing for a comfortable and financially secure retirement can be a full-time job. Whether you want to lounge by the pool at your condo in Boca Raton, Fla., or cruise to Branson, Mo., in an RV, getting on the right road to retirement isn't as daunting as it once appeared. With more investment options and benefits than ever before, and a progress report just a mouse-click away, it's unlikely we'll become a nation of octogenarian slave-laborers.

By Kerry Capell in New York

EDUCATION MATTERS

31% of college grads have saved more than \$50,000 toward retirement, vs. only 11% for their high school counterparts

SECURING YOUR FUTURE: A SELF-HELP GUIDE

BUSINESS WEEK and leading financial planners clear a path through the thicket of choices

Life would be much simpler if there were one formula that everyone could use for retirement investing. But there isn't—and so we labor over asset-allocation ratios, scour mutual-fund reports, and endure guilt-inducing financial sales pitches. Alternatively, we hire a planner to do the

RETIREMENT GUIDE

work or put our fate in the hands of, um, a trusted stockbroker friend.

BUSINESS WEEK has another idea: a self-help guide to retirement investing that can get you well on your way to a sensible plan. Once you figure out how much you'll need to save—a task made easy by personal computers and the Internet (page 88)—you'll be set to select among model portfolios from the tables below. We developed these models with the help of Alpha Group, a network of eight of the nation's leading financial-planning firms, collectively managing \$1.4 billion. Together, we also selected a complementary group of mutual funds, suitable whether your portfolio is \$20,000 or \$2 million. Each fund is a leader in its class, widely available, and inexpensive: None levies a sales charge, and our model portfolios cost only half the fund industry's typical expense rate of 1.3%.

Assemble your own portfolio by picking funds from the table as needed. If your employer's plan has a good stock-index fund, use it, and when your account grows large enough, supplement it with our actively managed equity funds. If you're self-employed and building an investment plan from scratch, pick an entire portfolio. Likewise, if you're retired and figuring where to stash your nest egg, our table offers a full plan or a way to bolster your current holdings.

"GOLD TO LEAD." Buying funds such as these through a brokerage account offers clear advantages to a variable annuity. This increasingly popular tax-deferred savings vehicle is essentially a fund or menu of funds put inside an insurance policy. The problem is that the lure—tax-deferred investment growth—is outweighed by high fees and commissions, penalties charged for taking out your money early, and higher taxes down

the line. When you begin withdrawals, your annuity earnings are taxed not at lower capital-gains rates but at the higher rates imposed on ordinary income. "I've run scenarios upside down and backwards, but it just doesn't work out," says Harold Evensky of Evensky, Brown, Katz & Levitt, a Coral Gables (Fla.) financial-planning firm. "You end up turning gold to lead."

You can set up various accounts for retirement savings at banks, insurance companies, and brokerage firms. But discount brokers, with their low transaction costs and diverse products, may be the best way to go. Deena Katz, a partner at Evensky, Brown, thinks full-service brokers, insurers, and more limited mutual-fund companies should be

avoided because they're either riddle with commission schemes, have other sales incentives to steer you toward their own mutual funds—which may not be the best ones for you—or offer a shorter list of investment choices. She suggests turning to such discount brokers as Charles Schwab (800 694-9449) and Waterhouse Securities (800 934-4410) and Quick & Reilly (800 533-8161), which have a wide range of product and many offices nationwide. Fidelity Investments' brokerage arm (800 542-8888) has a smaller office network but is also a good choice because of the extensive list of mutual funds it carries.

The sections below detail how and when to use the retirement-savings accounts that are best for you, depending

PICK YOUR IDEAL RISK-RETURN BALANCE AND FIND FUNDS THAT FIT YOUR GOALS

*Each allocation below offers
a different expected return
at a different level of risk.
Aim for no more return than
you need while taking no more
risk than necessary.*

PORTFOLIO VOLATILITY	EQUITIES/ FIXED- INCOME	EXPECTED RATE OF RETURN*	PROBABLE RISK**
LOW	50%/50%	7.3%	-10%
MEDIUM	60%/40%	7.8%	-13%
HIGH	70%/30%	8.2%	-16%

*Assumes 3% inflation

**Probable worst-case loss in any 12-month period

DATA: EVENSKY, BROWN, KATZ & LEVITT, BUSINESS WEEK

FIXED INCOME MATURITY RANGE

3-5 YRS 5-10 YRS

SAMPLE INVESTMENTS* PHONE (800)	SOLON 3-YR BOND 467-6566	VANGUARD GNMF 662-7
------------------------------------	-----------------------------	---------------------------

LOW VOLATILITY	50%	0%
MEDIUM VOLATILITY	40%	0%
HIGH VOLATILITY	30%	0%

SAMPLE INVESTMENTS* PHONE (800)	SOLON 3-YR BOND 467-6566	VANGUARD GNMF 662-7
------------------------------------	-----------------------------	---------------------------

LOW VOLATILITY	33%	17%
MEDIUM VOLATILITY	26%	14%
HIGH VOLATILITY	20%	10%

SAMPLE INVESTMENTS* PHONE (800)	SOLON 3-YR BOND 467-6566	VANGUARD GNMF 662-7
------------------------------------	-----------------------------	---------------------------

LOW VOLATILITY	33%	17%
MEDIUM VOLATILITY	26%	14%
HIGH VOLATILITY	20%	10%

SAMPLE INVESTMENTS* PHONE (800)	SOLON 3-YR BOND 467-6566	VANGUARD GNMF 662-7
------------------------------------	-----------------------------	---------------------------

LOW VOLATILITY	33%	17%
MEDIUM VOLATILITY	26%	14%
HIGH VOLATILITY	20%	10%

*Fund choices developed by Alpha Group with BUSINESS WEEK

n your situation. If your employer offers a 401(k) or some other savings plan, you'll want to implement your retirement-savings program very differently than if you're self-employed and doing it on your own. And if you've already retired, you'll have another batch of questions, including perhaps the most pressing one: How will I ensure I'll have the cash flow I need to live on? For answers to that and more, look for the situation that most closely fits your life.

BOILING IN THE FIELDS OF CORPORATE AMERICA

Workers at big companies with fancy retirement plans may feel secure in the expectation that their employers are looking out for them. Not Babak Banapour, a 36-year-old research biologist who has had retirement accounts at Harvard University and drugmaker Rhône-Poulenc Rorer. What galls him is "how the employers dictate our 401(k) choices," he says. "I look forward to a day when 01(k) plans become much more self-



directed." That's why, since leaving Rhône-Poulenc Rorer a few months back, Banapour has rolled over most of his \$47,000 in savings into an individual retirement account (IRA) at T. Rowe Price Associates, which he favors for its low costs, wide selection of

BABAK BANAPOUR
What galls the 36-year-old bioresearcher is "how employers dictate our 401(k) choices"

funds, and flexibility.

Do you, like Banapour, feel overwhelmed by the investment options in your company's retirement plan? Unfortunately, you won't be able to liberate your savings until you and your employer part. Yet you can set up special accounts on your own to supplement your employer's plan. You may want to do that even if you like the investment choices you have at work but find yourself bumping up against the \$9,500 annual ceiling on pretax contributions.

To get the most from all your retirement accounts, the trick is to fund them systematically. Think of all the options as a cascading series of savings pools that you want to fill each year according to your ability and in the right order.

First, regardless of how cheezy your employer's plan may be, keep funding it to the annual maximum of \$9,500 as

EQUITIES

DOMESTIC					INTERNATIONAL		REAL ESTATE	
LARGE-COMPANY		INDEX	SMALL-COMPANY		DEVELOPED WORLD	EMERGING MARKETS	REITS	
VALUE	GROWTH		VALUE	GROWTH				
\$25,000 PORTFOLIO								
		VANGUARD SMALL CAP 662-7447			WARBURG PINCUS INT'L EQUITY 927-2874			
0%	0%	10%	0%	0%	16%	0%	0%	
0%	0%	12%	0%	0%	19%	0%	0%	
0%	0%	17%	0%	0%	20%	0%	0%	
\$100,000 PORTFOLIO								
		VANGUARD SMALL CAP 662-7447			WARBURG PINCUS INT'L EQUITY 927-2874			
0%	0%	10%	0%	0%	16%	0%	0%	
0%	0%	12%	0%	0%	19%	0%	0%	
0%	0%	17%	0%	0%	20%	0%	0%	
\$300,000 PORTFOLIO								
DODGE & COX STOCK 621-3979	HARBOR CAPITAL APPRECIATION 422-1050	VANGUARD SMALL CAP 662-7447			VANGUARD INT'L GROWTH 662-7447	MONTGOMERY EMRGMG MKTS 572-3863	COHEN & STEERS REALTY 437-9912	
11%	9%	7%	0%	0%	12%	4%	7%	
14%	11%	9%	0%	0%	14%	5%	7%	
19%	14%	11%	0%	0%	15%	5%	6%	
\$1 MILLION PORTFOLIO								
DODGE & COX STOCK 621-3979	HARBOR CAPITAL APPRECIATION 422-1050	LONGLEAF PARTNERS SMALL CAP 445-9469	N/I MICRO CAP** 686-3742		VANGUARD INT'L GROWTH 662-7447	MONTGOMERY EMRGMG MKTS 572-3863	COHEN & STEERS REALTY 437-9912	
12%	8%	0%	5%	2%	12%	4%	7%	
14%	11%	0%	6%	3%	14%	5%	7%	
19%	14%	0%	7%	4%	15%	5%	6%	

**Fund expects to close after 8/31/97

long as your contributions are matched. If your employer gives you, for example, 50¢ for every dollar you invest in your 401(k), that's free money. Take it.

Once you've grabbed every free buck, keep saving in your 401(k) with unmatched contributions. But as soon as

RETIREMENT GUIDE

you've saved as much that way as you can—or if your employer's investment options are wholly uninspiring—your next step is to open an IRA. Do this even though none of your contributions (\$2,000 a year maximum, plus \$2,000 for a spouse) will be deductible from current income, as they are for IRAs funded by people who don't have employee-sponsored retirement plans or who earn less than \$50,000. Do it because your savings will compound without being taxed until you begin taking withdrawals, which you needn't do until age 70½. Do it also because it gives you a chance to invest in better funds than those available in your 401(k). Finally, do it even though you may be able to contribute more in aftertax dollars to your company plan than the \$9,500 pretax limit. Yes, your money would grow there under the company plan's tax shelter, but you'll be putting still more money in an account you have limited control over.

What should you do next? If you've put all you can into your 401(k) and you've maxed out your annual IRA contribution, your next move is simply to open a regular investment account with a discount broker. In this account, you needn't trade stocks and bonds—though those are available to you—but you will be able to purchase and hold mutual funds, such as those in our table, which complement the funds in your IRA and 401(k). For example, if your 401(k) offers a good growth-stock investment option, don't attempt to duplicate that in your brokerage account. Try instead to fill the gaps in your employer's plan.

The difference between qualified retirement plans and this regular brokerage account is that you'll be obliged to pay taxes each year on any dividends or capital gains generated by the funds in the account. To minimize the tax bite, Jane King, president of Fairfield Financial Advisers in Wellesley, Mass., suggests sticking to stock funds that don't turn over their holdings very of-

ten. One fund in our table that trades infrequently and generates little in annual capital gains is Dodge & Cox Stock, which holds its shares for an average of 10 years before selling. Another low-turnover choice is Schwab 1000, a stock-index fund that, like all funds that track indexes, sells rarely. Little trading activity also lowers the fund's commission costs. Those savings, plus lower taxes, let your gains compound more swiftly.



■ MYRA AND SAMUEL GREEN
SEP-IRAs allow business owners to defer taxes on up to 15% of their earnings, or \$24,000 max

SAVING WHEN YOU'RE SELF-EMPLOYED

The janitorial business Myra and Samuel Green are building in Austin, Tex., is barely more than a year old. Still, the Greens know they should be setting aside some of the revenue from Sammee's Cleaning Service for their retirement. They just don't know how. "There is so much information out there," says Myra Green. "I'm just looking for a good place to start."

Well, Ms. Green, remember this acronym: SEP-IRA, or Simplified Employee Pension-Individual Retirement Account. With a SEP-IRA, the self-employed can put aside as much as 15% of

their earnings each year, to a maximum of \$24,000. And you can do this even if you or your spouse works for a company with its own retirement plan, as Ms. Green, an office manager at a semiconductor maker. The key is having a profitable business, whether it's a full-time occupation, as the janitorial service is for Mr. Green, or a consulting practice you maintain alongside a corporate career.

Setting up a SEP-IRA is little more

difficult than opening a regular IRA. In fact, the main complication to a SEP-IRA is the wickedly intricate calculation of Internal Revenue Service demands, so before you'll know how much in taxable earnings you've received from your business in the previous year and how much you can contribute to your retirement account. One depends on the other. Rad K. Grant, an accountant at Miami's Morrison, Brown, Anderson & Co., says popular income-tax software programs such as TurboTax crunch the numbers in a snap, so if you have a computer or an accountant does your taxes, don't do yourself nuts doing it by hand.

ASSET POOL. Once you've set up a SEP-IRA, the more important issue will be

how to allocate your savings among different investments. Here is where our table on page 62 comes in. For smaller portfolios of \$25,000 or less, no more than four mutual funds are needed. Indeed, the smallest accounts can get by with a short-term bond fund and a large-company index fund, such as the Solon Short Duration Three-Year Bond and Schwab 1000 funds in our table.

As your business grows and your retirement account swells along with it, should the number of funds in your portfolio. You also should view the funds in your SEP-IRA as one piece of a financial puzzle that might also include funds you've rolled over from a previous job into an IRA or investments held in your spouse's 401(k). "You want to look at these as a whole pool of assets," says King, and choose funds to suit the

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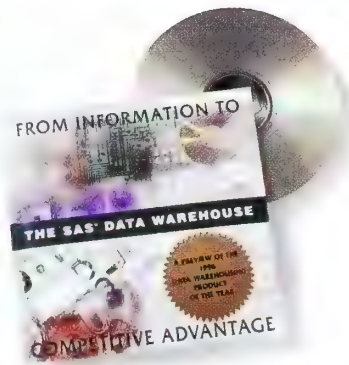
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whole, not any one account. All told, you need no more than 9 or 10 funds of the kind our table shows for portfolios of \$1 million or more.

For the self-employed whose businesses soar, Keogh plans make a better choice because they allow higher levels

RETIREMENT GUIDE

of pretax annual savings—25% of earned income, up to \$30,000 a year. That can be especially helpful to older businesspeople who find themselves trying to catch up on their retirement savings with a limited number of years to do it in. For the self-employed with plenty of free cash flow, Keoghs “are still a license to steal,” says Cincinnati financial planner Michael Hengehold.

MAKING YOUR HOLDINGS GO THE DISTANCE

In his 37 years as a Procter & Gamble exec, Bob Beiring counted himself lucky, the beneficiary of one of America’s most generous retirement plans. So how come in the months after his 1994 retirement, he became a nervous wreck?

Like many retirees, Beiring left the corporate fold with a multimillion-dollar nest egg—in his case, a pile of P&G stock. At first, he played the options market, deriving extra income by selling covered calls, which works well in a flat or falling market. But soon, P&G shares began climbing, and Beiring was forced to sell stock to make good on the options contracts he had sold. “I had all this money in my hands, and I couldn’t sleep at night,” he says. That’s when he decided to find a financial planner to help him reallocate his holdings among an array of mutual funds and corporate bonds. “I’m not an expert,” he says. “I was happy to turn it over.”

COSTLY COUNSEL. If you have retired—or are planning to soon—you might do the same. But be prepared to pay. Some planners charge as much as \$2,500 for an initial plan and then 1% of your assets annually. For a \$1 million portfolio, that’s \$12,500 in the first year and \$10,000 or more thereafter. Likewise, bank trust accounts and brokerage “wrap” accounts often cost at least 1% of assets. All fees are negotiable—it never hurts to ask for a discount—but the point is, truly customized planning doesn’t come cheap.

Still, investing your retirement savings is not, despite what some planners will tell you, brain surgery. “None of what we do is beyond the ability of a person who has been able to bank a

million bucks in their lifetime,” concedes Hengehold, Beiring’s adviser.

If you do decide to manage your own savings, the first thing you must do is get control of the money. That means having however much or little you’ve built up in your employer’s plan paid to you in a lump sum and moving it via what’s called a trustee-to-trustee transfer into a custodial-rollover IRA.

To do that, first open a rollover IRA at a discount broker. Then, tell your

of your retirement, you’ll still wind up worse off. Planners say that strategy rarely leaves you with more money than if you keep sheltering your savings from taxes while letting it grow in an IRA.

Focus next on setting up your other investments. First, place your nest egg in a money-market account at your broker. If your federal tax rate is 28% or higher, a tax-exempt fund is very likely the best choice. Next, choose one of the mutual-fund portfolios outlined in our table.

How do you decide on your account? Planners suggest that you estimate how much you will want to withdraw in your first two years of retirement. That’s the amount you think you’ll need for all your early retirement expenses that won’t be covered by pension payments, Social Security, or income from rental properties or, perhaps, a part-time job. Keep

BOB BEIRING
“I had all this money in my hands, and I couldn’t sleep at night,” says the ex-P&G executive. “I’m not an expert.”



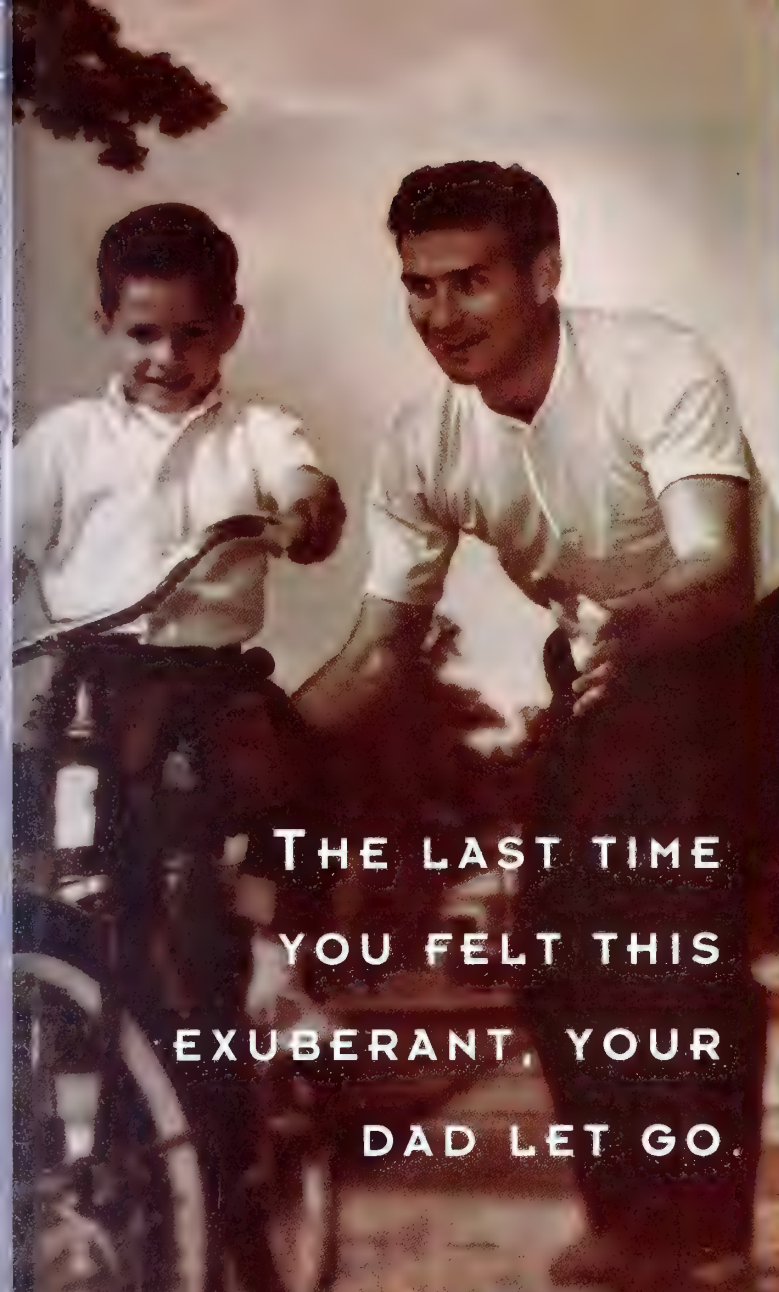
employer you plan to move your retirement savings into an IRA, and supply the account number. Employers typically will prepare a check made out to the IRA trustee “FBO”—For the Benefit Of—the employee. This could take as little as five days, but some slowpoke employers need nudging. Once you get the check, mail it or carry it to the broker’s office with your account application and instructions to place the proceeds in a money-market account within 60 days after the check was issued. (Wait too long and the government will consider the check a retirement distribution and tax you on it.) After the check clears, you can move funds from the money-market account into a variety of mutual funds, such as those on page 62.

When you retire, you’ll also have the chance to take the money directly. But you’ll be obliged to pay taxes on it. And, even though tax law lets you spread that pain over the first five years

that much in your money-market account. Also, don’t opt to reinvest the interest, dividends, and capital gains your mutual funds will distribute. Instead, direct those cash flows into your money-market account. Each year, you can evaluate your spending and decide whether you’re flush enough to plow those earnings on your nest egg back into mutual funds or whether your spending is higher than you estimated.

Eventually, you’ll probably also need to cash in some stock- or bond-fund shares to pay for a vacation home, make gifts to kids, meet unexpected expenses, or simply to refill your cash account. In those cases, says Minneapolis planner Robert Markman, peruse your funds and sell some of those that have done best. “You can wander the fields of your portfolio and ask: ‘Which fruit is ripe and ready for picking?’” he says. “Once twice a year, you pick some to eat.”

By Robert Barker in New York



THE LAST TIME
YOU FELT THIS
EXUBERANT, YOUR
DAD LET GO.



DEVILLE

For The Time Of Your Life

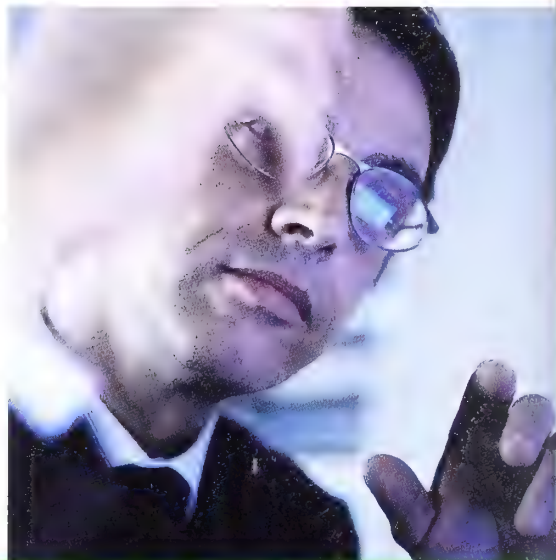
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CAN YOU PLUG ALL TYPES OF PEOPLE INTO ONE TYPE OF COMPUTER?





No.

After all, people are different. Jobs are different. Companies are different. And people need different types of computers to get their jobs done. Some need powerful PC's and workstations. Some need light and powerful laptops. Some need hand-held devices. Some need simple terminals running off a network. And some need a combination of machines.

Computers *must* be different to meet the different demands people have in their jobs.

And the reason computers *can* be different is because Microsoft® Windows® is the same.

This benefits everyone in your organization. If you're the one actually using the computer, for example, Windows looks and acts the same familiar way wherever you see it, so you can move from one device to another without having to learn anything new.

If you're the one managing the computer system, the Windows platform makes your life automatically simpler; you can deploy different systems in different departments for different jobs and maintain them as if they're the same.

And if you're the one paying for the system, you spring for just as much computing power as you need for each employee. Not less, not more. And your employees end up with the tools they need to get their jobs done.

Windows is, above all, flexible.

So, let's rephrase the question. Can you plug all types of people into one operating system?

Yes.

'THERE'S NEVER ANY REASON FOR US TO BE BORED'

You can be as active and mobile as ever in retirement—if you plan for it

When Edna Cohen first logged on to the Internet a few years ago, she was too overwhelmed to use it. But Edna, 79, and her husband, Aaron, 80, a retired Defense Dept. statistician, are giving it another shot: The Delray Beach (Fla.) couple is signing up for a one-week In-

never any reason for us to be bored."

More and more retirees like the Cohens, in good health and with their finances in order, are packing their days full of learning and adventure. And they are doing it with more energy and enthusiasm than college kids on summer break. Others, pursuing lifestyles once reserved for the rich and famous, are settling into bicoastal routines to share time with far-flung friends and relatives.

MORE CHOICES. Then there are those who really don't retire at all. Instead, they arrange to go right on doing what they've always enjoyed, albeit at lower pay or through volunteer work. "When my father retired, he put his feet up, turned on the TV, and waited to die," says Eugene Slevin, 74, a retired marketing consultant in Peoria, Ill. "I want

to die with my boots on." Slevin volunteers several hours a week to help low-income families prepare their taxes.

Sure, there will be time to kick back if that's what you really want. But the retirement game has changed drastically in recent times. That's mostly good, but it can also make planning for the golden years vastly more complicated than in generations past. Careful preparation is the key. "For the first time in history, older people have a plethora of choices," says Ruth Cohen, a Beaverton (Ore.) geriatric specialist (no relation to Edna and Aaron). "But unless you have a plan, you're not likely to get what you want."

For starters, do your homework before you pack it in. "Try to schedule out how long your funds will last," says

RETIREMENT GUIDE

ternet course at an elder hostel at Mary Washington College in Fredericksburg, Va. After that, they're off to Baltimore for a class on the paintings of Marc Chagall. Such trips are mere jaunts for the Cohens, who regularly travel to Africa on safari. "I am mad for wild animals," says Edna. "There's

HOT RETIREMENT LOCALES

The vital statistics, advantages, and drawbacks of some of the most popular communities

PLACE	POPULATION BY COUNTY	PER CAPITA INCOME	LEISURE ACTIVITIES	CRIME RATE* PER 100,000	CLIMATE
FAIRHOPE, ALA.	127,000	\$21,000	Golf, boating, beaches	3,277 ▼	Subtropical
PRESCOTT, PRESCOTT VALLEY, ARIZ.	148,600	\$18,800	Golf, hiking, sightseeing	3,662 ▼	Semi-arid, mountain
DURANGO, COLO.	40,000	\$22,700	Skiing, hiking, resident symphony	5,047 ■	Seasonal, temperate
PORT CHARLOTTE, FLA.	140,000	\$21,750	Golf, coastal boating, beaches	3,194 ▼	Subtropical
CAMDEN, ME.	38,500	\$23,600	Coastal and inland water, parks	3,225 ▼	Seasonal, temperate
PETOSKEY, HARBOR SPRINGS, MICH.	28,300	\$25,300	Great Lakes boating, beaches, fishing	4,641 ▼	Seasonal, temperate
OXFORD, MISS.	34,600	\$17,300	University arts, hiking, parks	7,227 ▲	Almost subtropical
BRANSON, MO.	35,300	\$21,900	Lakes, hiking, national forests, country music	6,740 ▲	Hot, continental
LAS VEGAS	1,060,000	\$26,400	Gambling, golf, theater and symphony, parks	6,936 ▲	Arid, desert
TRYON, N.C.	16,000	\$26,300	Lake Lanier, national forest	1,975 ▼	Seasonal, temperate
SAN JUAN ISLANDS, WASH.	12,400	\$32,500	Boating, beaches, parks	3,519 ▼	Marine climate

*▼ means the figure is below the national average by 10% or more; ▲ means it exceeds the average by at least 10%; ■ indicates it's within plus or minus 10%
DATA: DAVID SAVAGEAU, AUTHOR OF RETIREMENT PLACES RATED, WOODS & POOLE ECONOMICS INC.



BICOASTAL
Thanks to smart planning, Bob and Terry Ball are able to maintain houses in Florida and California

are you'll be glad to get back home after a few months in that cramped RV. And if you don't need that much house, you still have the option to sell and move. "The truth is, most retired Americans don't really want to spend the rest of

their lives traveling in a motor home—even if many think they do," says Dale Preator, a Los Angeles financial planner for American Express who teaches retirement seminars.

One popular option for retirees ready to trade in the old family homestead is a continuing-care community, a sort of all-in-one solution for growing older (BW—Feb. 17, 1997). For a hefty entry fee or endowment—typically \$100,000 to \$300,000—retirees are guaranteed a range of options from completely independent living right through to the time they require full-time nursing care. That's why dozens of such communities are springing up from California to Connecticut. Evergreen Woods in North

Branford, Conn., for instance, boasts 246 apartments and a 50-bed nursing home on an 88-acre complex. The campus includes a bank, beauty salon, library, swimming pool, and gym.

If nonstop travel or a deluxe retirement community is beyond your reach, consider ways to lighten your financial load. One obvious solution is to move into a smaller house. "You have to look at your principal residence and ask yourself: Do I really need that? If you need more income, it's time to shift your portfolio," says Kahn. If you are determined to keep your house, consider a reverse mortgage—borrow against the equity in the house and use the monthly payments to live. The rub: Over the years, you'll deplete your equity, so you may wind up leaving

id Kahn, an accountant who specializes in retirement at Goldstein, Goltz & Kessler in New York. If you don't have enough, keep working and saving. Then there is the issue of health care: long-term-care insurance while it is affordable—well before you reach 65. That way, you'll be able to enjoy whatever way of living you choose well into old age.

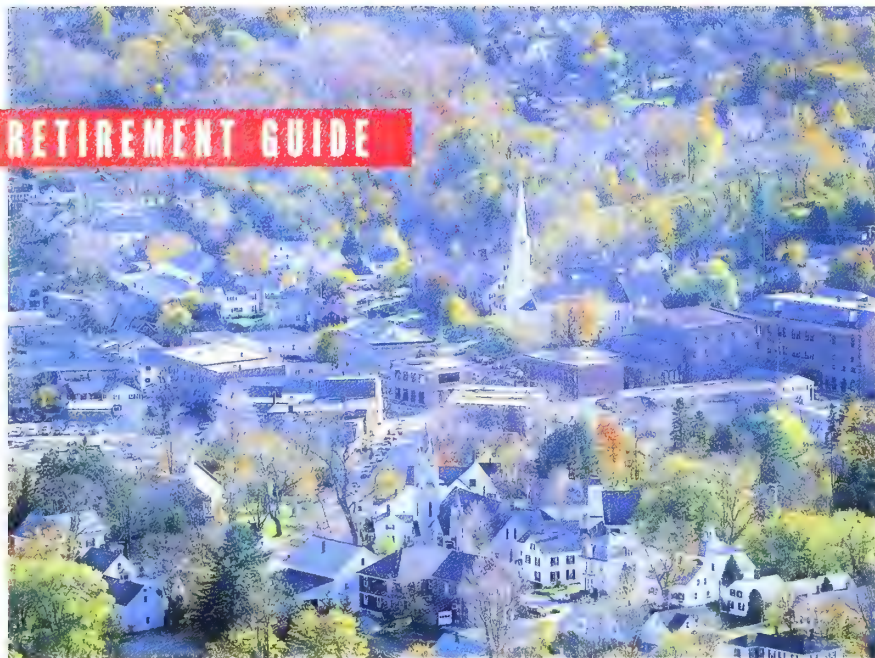
When you retire, the biggest dilemma

is where to live. For many, the urge to cash in the house and move to some exotic locale or finally take that deluxe around-the-world cruise is irresistible. But even aside from financial considerations, that's a huge mistake. A much better plan is to hold on to your house for a few years, even if it seems too big. Instead, rent it out while you try your fantasy life. Then, if you tire of the fantasy, you're not stuck. Chances

HEALTH CARE AVAILABILITY	PROS/CONS
4 hospitals, 82 office-based physicians	+ Near Mobile, Ala.; good arts scene; low crime – Hurricane-prone; rising housing costs
2 hospitals, 99 office-based physicians	+ Victorian architecture; low crime; growing economy – Traffic congestion; few restaurants
1 hospital, 51 office-based physicians	+ Mountain college town; Victorian architecture – Cold, snowy winters; high housing costs; remote location
3 hospitals, 110 office-based physicians	+ Low crime; growing economy; Gulf locale – Torrid summers; few cultural, artistic amenities
1 hospital, 51 office-based physicians	+ Coast location; low crime; good arts – Cold winters; costly housing; dim employment forecast
1 hospital, 81 office-based physicians	+ Low crime; wonderful outdoor recreation – Severe winters; far from major cities; slow job growth
1 hospital, 38 office-based physicians	+ College town; good arts and culture; low taxes on retirement income – Humid summers; high property-crime rate; limited outdoor recreation
1 hospital, 13 office-based physicians	+ Low cost of living; nearby water recreation; growing economy – High property crime rate; wet winters
7 hospitals, 743 office-based physicians	+ Mild winters, expanding economy; big-city amenities like public transportation; lots of performing arts – High crime; congestion and sprawl; scorching summers
1 hospital, 12 office-based physicians	+ Mild climate; low crime; horse country – Lack of big-city arts; poor employment outlook
0 hospitals, 16 office-based physicians	+ Unspoiled environment; low crime; no congestion – Isolation; accessible only by ferry; rising housing costs

** Forecasts are for new jobs in finance, insurance, real estate, retail trade, and services—industries in which older adults find most opportunities. ■ means roughly the same growth rate as the U.S. average of 11.3%; ▲ is at least twice the average; ▼ is slower.

RETIREMENT GUIDE



little to your heirs.

Tax planning is another concern. Obviously, those free and clear of a mortgage are in the best position. But if you have a small mortgage, almost all of it is paying for principal, so you are losing tax deductions. It may pay to increase your deductions with a home-equity loan. With the money you save in deductions, you could take a vacation or put a new roof on the house. And if you have savings in Treasury bonds, spend that money as it matures before dipping into taxable pension assets.

The trick, however, is to go beyond financial considerations in mapping out your golden years. Don't think strictly in terms of selling your house for monetary gain. Instead, make sure to focus equally on the all-important issue of what it is you actually want to do and how you want to spend your time. Then ask yourself how much money you'll need to do it. The secret to success, in all cases, is to develop deep interests outside work—years before the boss hands over the gold watch. "Playing golf sounds wonderful," says

■ IN COUNTRY
Branson, Mo., is convenient to hiking, sailing, and swimming—and as a music lover's paradise, it's a country cousin to Nashville



Jeff Rosenfeld, a New York geriatric specialist. "But that doesn't last long. Successful retirees have passions outside of work."

But remember: One person's dream retirement is another's nightmare. Take Eric Daniel, a retired Memorex executive who, with his wife, Arlene, raised a daughter and a son in a five-bedroom house in Woodside, Calif. The Daniels

don't enjoy traveling and aren't interested in playing endless rounds of golf and tennis. Trained as a physicist, Eric has always been passionate about painting. So the Daniels sold their aging family house "when the doorways started looking like parallelograms instead of rectangles." Now, the couple lives

■ DOWN EAST
Camden, Me., is a postcard-pretty New England town with dazzling autumn foliage, nearby mountain trails, and a rich maritime history

in a much smaller house just five minutes away in Redwood Cliffs, where Daniel converted the spare bedroom into a 24-foot-by-12-foot studio. The renovation was easily covered by the capital gain pocketed upon selling their old home. And they got a 25% tax break to boot. The first \$125,000 was tax-free because the Daniels were over 55.

FAMILY MATTERS. Increasingly for many older Americans where and how you live is dictated as much by complex family situations as by personal interest. And in an age of divorce and increasing longevity, multiple marriages seem the rule rather than the exception. That means step-grandchildren and countless other relatives to consider. For Terry and Bob Ball, both widowed when they married in 1995, the dilemma of having families and lifelong friends on different sides of the county nearly proved a deal-breaker. So Terry, 68, and Bob, 74, compromised: They live 18 months a year in Melbourne, Fla., and 10 months in Malibu, Calif. Terry

■ WATERWORLD
San Juan Islands, Wash., offer a temperate climate—and the splendid isolation of a community reachable by ferry only

Balls are not money stars with deep pockets. But thanks to savvy investments and smart planning, they are able to swing this pattern with ease—and with frequent-flier miles to spare.

Bob, a retired Lockheed engineer with three sisters, three sons, and various grandchildren, all in California, has been living in an upscale trailer park in Malibu's Paradise Cove, one of the



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most scenic spots on the California coast. Terry lived in the three-bedroom Jacksonville (Fla.) house she had long shared with her late husband. Terry sold the house, and the Balls bought a condo in Melbourne, Fla., at Indian River Colony Club, a retirement community for former military officers. (Both

RETIREMENT GUIDE

Bob and Terry's first husband were former officers.)

To save about \$5,000 a year in California income taxes, Bob switched his legal residence to Florida. With income of about \$7,000 a month, made up of Bob's pension and some stock dividends plus \$2,000 from Terry's survivor's benefit package, the couple has no trouble paying the condo fees and the \$715 rent for the space in the Malibu trailer park. And with so much travel, they use frequent-flier miles to upgrade to first class and to help pay for European vacations.

For countless others, the best plan of action is simply to stay put. That's what John and Virginia Wolf decided to do after John took early retirement from his job as service manager of a Van Nuys (Calif.) Ford dealership in the late 1970s, at 47. Even though the couple had already paid off the mortgage on their small three-bedroom ranch house and could have leveraged into a bigger or fancier place, all John wanted to do was tinker in the garage and dabble in the stock market.

MOONLIGHTING. Wolf, now 69, has expanded his interests to include car racing and antique auto collecting. Wolf has about \$400,000 tied up in his hobby, mostly in a single drag race car he built from scratch. He and a team of technicians and a driver travel the West three or four times a year to enter races. The Wolfs also take a couple of other trips a year in one of their nine antique Fords, as members of an auto touring club.

To indulge in this hobby, Wolf worked a second job at night for 19 years and saved like mad, investing every spare penny in the stock market. For 40 years he has put a little here and a little there into such holdings as Lockheed, Boeing, and Ford. He even swore off life insurance to have more to put into the market. And Wolf has no pension, living strictly off his dividends.

With so many choices, figuring out where to retire is itself turning into a time-consuming job. But whether you want to race cars, go on safari, or stay home to paint, the goal is to end up like Edna Cohen. "Don't feel bad if I die tomorrow," she says. "I've had a wonderful life." Who could ask for more?

By Eric Schine in Los Angeles

GENERATION X

TO BE YOUNG, THRIFTY, AND IN THE BLACK

Ann Farrell, a 28-year-old hydrogeologist, is one of the lucky ones. As a senior at Smith College in 1991, Farrell attended a seminar on investing early for retirement. "I remembered the figures if you started saving when you were young," she says.

Indeed, the payoff is huge. Through compounding, 25-year-olds who invest \$2,000 a year and stop at 34 will earn \$142,000 more by the time they are 65 than someone who begins investing \$2,000 at 35 and contributes \$2,000 each year for the next 30 years, according to T. Rowe Price Associates.

Farrell already has \$22,000 in her 401(k). That's a nice start compared to most of her peers. Public Agenda, a New York-based market research firm, found that nearly 70% of polled adults aged 22 to 32 had saved less than \$10,000 for retirement.

When Farrell was a new employee in 1991 at Roux Associates, an environmental consulting firm in Methuen, Mass., she was barred for a year from the company's Fidelity-managed 401(k) plan. Once eligible, she committed 8% of her paycheck in the two most aggressive stock funds offered (retirement growth and asset manager). The company matched 50% of her pretax contributions, up to 5% of her \$28,000 salary.

Of course, it helped that her expenses were low. After graduation, Farrell—with only \$500 to her name—moved back in with her parents, who charged her \$200 a month for rent. She also traveled three out of every four weeks for work. "There is nowhere to spend money on the road," she claims. Still, she had to repay a \$10,000 school loan and a \$4,000 car loan. She also wanted to build an emergency slush fund. Once

she began making headway on these goals, Farrell moved to her own place and gradually increased her pretax contribution to 10%. Last year, she upped it to 13% (the maximum) of her annual salary, which has hit \$40,000. The government allows

employees to make a pretax contribution of up to \$9,500 a year. Farrell is currently chipping about \$5,000 a year.

Oddly, the lack of growth in environmental consulting has worked to Farrell's benefit. While most GenXers find themselves job-hopping every two years or so to get ahead, Farrell stayed put because there wasn't much movement in her industry. So she will become fully vested in her 401(k) this October, after five years in the plan.

But Farrell hasn't exhausted all her retirement savings possibilities. Even though IRA contributions are fully tax-deductible only if a single person makes less than \$35,000 a year (\$50,000 for joint filers), Farrell can still benefit from the tax-deferred growth of the interest on her annual \$2,000 contribution. For example, if she contributes \$2,000 a year for 30 years, Farrell will earn \$47,000 more in a nondeductible IRA than in a taxable account, assuming 28% federal tax rate, according to T. Rowe Price Associates.

Farrell has done a lot right, but she has a long road ahead of her. When she makes her next move—she may leave her company and go to B-school—she needs to recognize the potholes that exist when protecting her retirement assets. For instance, if she decides to roll over her 401(k), she'll have to examine all of the investment options and rollover requirements. If she messes up, she could lose her head start on retirement savings.

Toddi Gutne



SUPER SAVER: Farrell already has \$22,000 in her 401(k)

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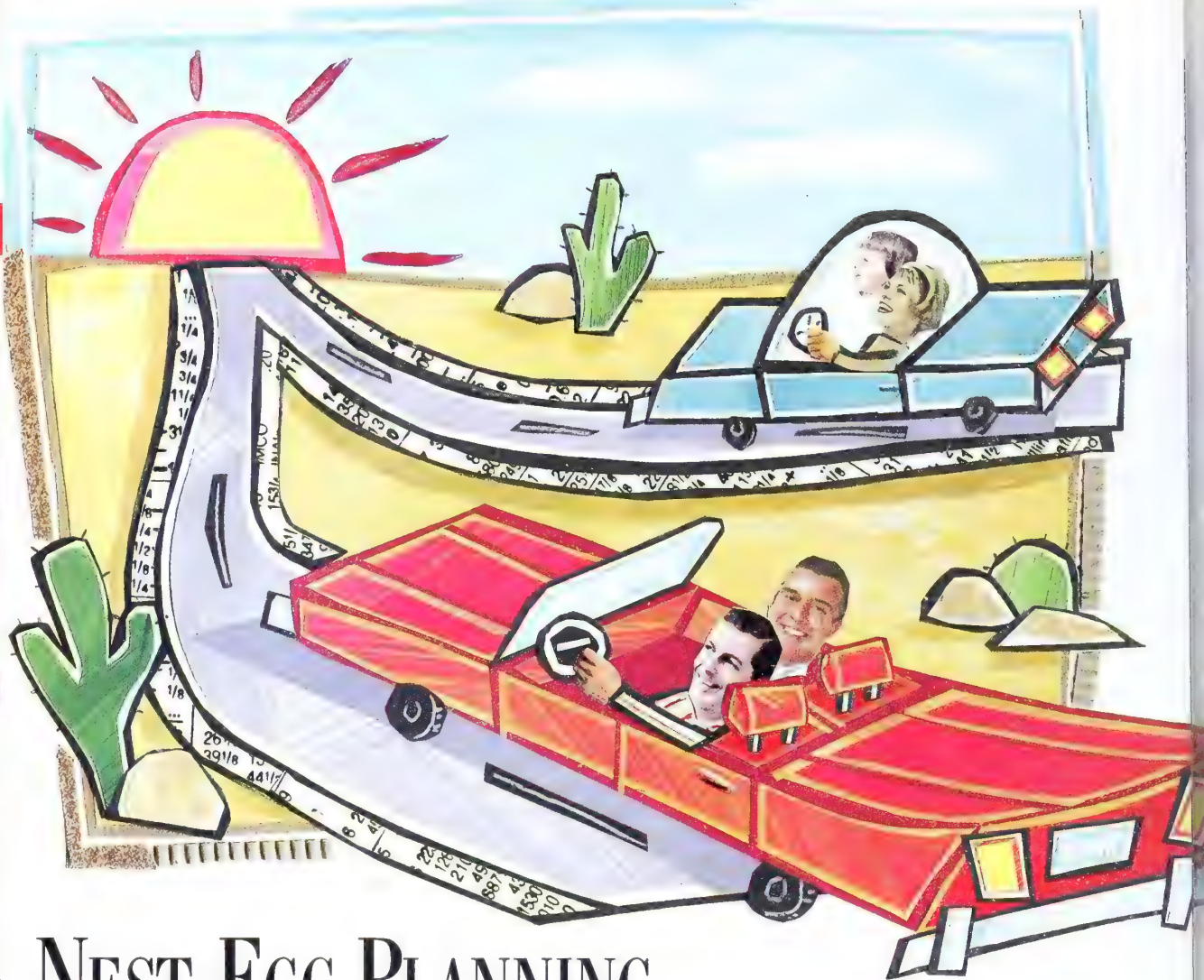


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NEST-EGG PLANNING FOR THE NOT-SO-AVERAGE JOE

Start early and consult with pros, as the law is filled with pitfalls

Many retirement-planning strategies nicely accommodate the traditional husband-wife-kids family unit. But times have changed, and millions of nontraditional households have decidedly noncookie-cutter retirement needs. Nearly half of all American marriages end in divorce,

Financial planners and estate attorneys universally offer such households the following self-serving, but smart, advice: Plan early, and get expert help. The law provides plenty of protections for married couples, but it's filled with pitfalls for almost everyone else.

Indeed, corporate benefits routinely extend to spouses of employees, but do not always protect unmarried partners. That's why people with nontraditional living arrangements need to set up their own safety nets, prepare special legal documents, and plan independently for retirement. "It's important in these situations to get all your i's dotted and t's crossed far in advance of retirement so nothing goes wrong or is challenged

after death," says Elizabeth S. Levitt, author of *Financial Fitness for Living Together* (\$14.95, Facts On File).

Divorced working mothers are among those most in need of careful retirement planning, says Bird Patrick, president of Security General Financial Management in Boston, which specializes in financial planning for women. Once a woman emerges from a divorce, her household budget typically becomes badly stretched, and savings start to disappear. Patrick advises these women to quickly establish a household budget that allows for automatic monthly savings, and develop specific retirement goals. "Usually, it's impossible to live at the same standard" as before the

RETIREMENT GUIDE

creating headaches for millions of adults thinking about their retirement years. Likewise, single parents, gays and lesbians, and those who choose to live together outside of marriage all have formidable retirement-planning challenges.

I FIND THE GREAT THING IN THIS WORLD
IS NOT SO MUCH WHERE WE STAND, AS IN WHAT DIRECTION WE ARE MOVING. -Oliver Wendell Holmes, Jr.



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voice, Patrick says. But for most divorcees to retire in comfort, they'll need more than just Social Security and the proceeds of their company retirement plan, she cautions.

One critical matter facing divorced women as they plan for their golden

RETIREMENT GUIDE

years is whether they're entitled to 50% of their ex-spouse's company retirement plan, an issue not always dealt with in divorce settlements, Patrick says. While the money could come in handy, it would likely take a court battle to get it. Another option, though not always recommended because of the expense and hassle, is to take out life insurance on your ex-spouse if he or she is responsible for child support. You'll need the consent of your ex, of course, which may not be possible if your parting was acrimonious.

EXCITED. Once the smoke from the breakup has cleared, divorced women should plan for retirement much the same way married people should: Contribute the maximum to the company retirement plan, set up an emergency fund through automatic deductions from their checking account, and, if there are children, properly providing for them through a will and by getting insurance that takes care of them if neither parent is able.

Following this strategy has Bridget Marron, a 37-year-old single mom, excited not just about retiring—but about retiring early. After her divorce 10 years ago, Marron never managed to save any money beyond her 7% contribution to the 401(k) plan offered by the Boston health-care provider she works for. The employer matches 100% of her contribution. Although Marron receives child support from her ex, her \$42,000 annual salary left her worried about paying for both her daughter's college education and her own retirement.

But last year, she cut back on day-to-day expenses and be-

gan a savings plan. She set up a college fund for her 12-year-old daughter, bought whole life and disability insurance, and began putting \$100 a month into savings. Along with \$37,000 in 401(k) money already saved, "it probably means I can retire at 59½," she says.

Single parents, divorced or not, should also face the morbid business of planning for their demise as part of retirement planning. David Scott Sloan, chairman of trusts and estates at Sher-

lack any legal right to their companion's assets upon their disability, death, or if the partnership breaks up. No divorce court exists to handle a split between live-in partners. Unmarried couples also lack the so-called marital deduction, which allows spouses to pass on everything they own to their surviving spouse tax-free. Only the first \$600,000 of an unmarried partner's assets is exempt from estate taxes.

Indeed, it's important to understand

Some gays and lesbians wrongly think that since they don't have massive child-rearing expenses, retirement planning is "the straight man's burden"

burne, Powers & Needham, a law firm in Boston, says simply leaving money to your kids can result in a huge estate tax bill, sharply decreasing funds available if your estate is worth more than \$600,000—the amount you can leave to heirs tax-free. Although Congress is considering legislation to raise that limit to \$1 million, Sloan recommends setting up a trust for the children's benefit in the event of your disability or death.

Unmarried couples face formidable retirement-planning challenges. Partners

the legal implications of not being married. If you own a home together, share property or debts, or have assets you want to pass on to your partner rather than children from prior marriages or other relatives, having legally binding agreements in place is crucial to ensuring each partner's secure retirement, experts say. Out-of-wedlock couples should also plan well in advance for the disposition of company retirement plans. Rules vary, so there's no hard-and-fast way to handle the issue. The first step,

says Jane King, president of Fairfield Financial Advisers in Wellesley, Mass., is to decide on a beneficiary and a distribution method.

HOSTILE. If no beneficiary is named in your pension plan, the plan sponsor is required to give the proceeds to your closest blood relatives. So if you want your partner to receive the plan proceeds after you die, make sure he or she is named the beneficiary. Also, check if the plan allows live-in married partners to receive so-called joint and survivor benefits. That would allow plan distributions to your partner after you die. When selecting a distribution method, it's critical to tell your employer how you want to receive it before you retire because the pe-

RETIREMENT PLANNING FOR TODAY'S LIFESTYLES

DIVORCEES

- Maximize contributions to your retirement plan at work, and begin separate savings account to protect retirement assets.
- Consider taking out life insurance on your ex-spouse if he or she is responsible for child support. Buy disability insurance.
- Revise your estate plan after the divorce. In some states, a divorce doesn't automatically revoke your will or certain trusts if your ex-spouse is a beneficiary.

UNMARRIED COUPLES

- Determine early if your employer allows a joint-and-survivor benefit for a nonspouse. If so, inform your plan administrator while you're still employed, since the method of distribution can't be switched after you retire.
- Blood relatives will usually win out in disputes over assets that arise after death. Clearly spell out your intentions in legally binding documents. At a minimum, have a will.
- Unmarried couples don't receive an unlimited exemption from estate taxes as do wedded couples when the first partner dies. Therefore, consider techniques to minimize estate taxes, such as a charitable remainder trust.

GAYS & LESBIANS

- Consider saving more than the usual 75% to 85% of gross pre-retirement income if family relations are strained and relatives may not provide support.
- A partner has no right to the proceeds from his or her companion's defined benefit pension plan if the companion dies before distributions begin.
- Unmarried partners are not entitled to their partner's Social Security checks after their partners die.

DATA: BUSINESS WEEK



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Equity-Income	Fidelity Equity-Income	16.94	Medium Company Value	18.26
Small Company	Janus Venture	12.93	Small Company Blend	16.33
Foreign Stock	Templeton Foreign	9.60	International Stock	11.59
Corporate Bond	Fidelity Intermed. Bond	4.64	Bond & Mortgage	6.43
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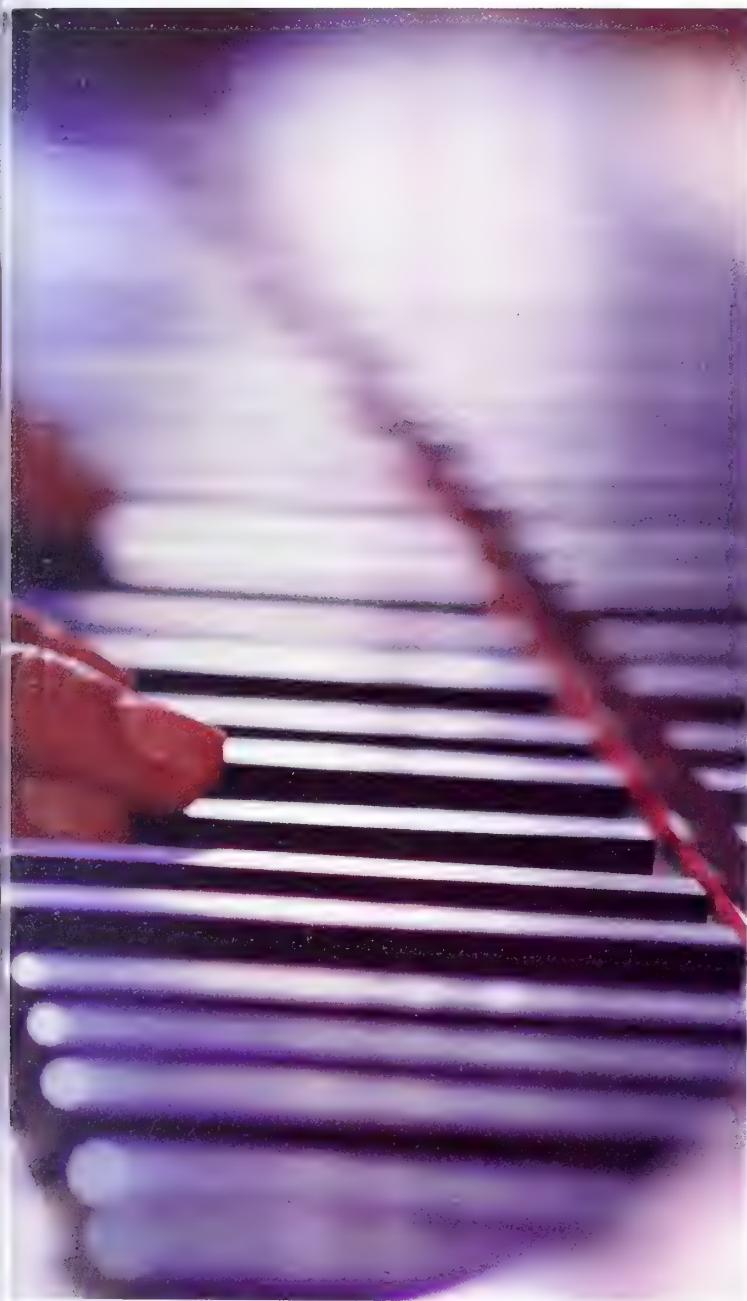
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ments can't be changed once they begin.

Gays and lesbians face similar legal hurdles. Peter M. Berkery Jr., author of *Personal Financial Planning for Gays and Lesbians* (\$24.95, Irwin Professional Publishing), warns that the U.S. financial infrastructure—including the tax

expenses, retirement planning is "the straight man's burden."

But Berkery says the opposite is true. Retirement planning for gays is even more critical because they face so many obstacles. It's not uncommon for hostile blood relatives to launch—and win—nasty court battles over the ownership of assets after death. So Berkery recommends that when planning for retirement, gays should clearly spell out ownership issues in legally binding documents. He also says they should save slightly more money than the averages recommended for straight couples. Why? If they're alienated from their families, they will receive less emotional—and

financial—support as they grow old. Lawyers and financial planners sometimes resort to scare tactics to alarm clients about the pitfalls of poor planning. They tell stories of divorced women scraping by with nothing left for retirement, and unmarried partners getting tossed out of their homes by their partner's hostile children. That's why it's often worth seeking expert assistance. "There are lots of things you won't think of, but chances are a professional will think of them for you," says King. Thanks to a legal system that's tricky for nontraditional households, that could be wise counsel.

By Geoffrey Smith in Boston

RETIREMENT GUIDE

code, the investment process, and the probate process—is hostile to the retirement needs of gays and lesbians. Another problem, Berkery says, is that some gays and lesbians think that since they don't have massive child-rearing

SANDWICH GENERATION

ONE FAMILY TRIES TO EASE THE BITE

The nest was empty, and Gail and John O'Neil were settling into a comfortable future. One daughter had been out of college for a couple of years and the other was halfway through. "I'd call John at work and say: 'Where should we go for dinner?'" recalls Gail, 48, a registered nurse who earns \$30,000 a year. John, 57, a technical specialist at Abbott Laboratories, brings home \$75,000.

Today, the O'Neils aren't splurging. As planned, 19-year-old Rebecca, a junior at Illinois State, returned to their four-bedroom house in Mundelein, Ill., for the summer. Then 24-year-old Texas Tech grad Jennifer unexpectedly moved back in April while searching for a job. A month later, John's mom, Evelyn, joined them from Florida, because she could no longer care for herself. Suddenly, the O'Neils epitomized the "sandwich generation," people squeezed financially by having to care for both older and younger family members—while also charting their own retirement course.

DRUG BILLS. With three extra mouths to feed, it's been touch-and-go. Evelyn, 86, has periodic health problems—a frail heart that has undergone bypass surgery, failing eyesight, and Sundown dementia, a disorder that leaves her disoriented after dark. The couple paid for Evelyn's move back to Illinois. The former Raytheon supervisor gets \$600 in So-



THE O'NEILS: Health costs are a major concern

cial Security checks per month and a \$150 monthly pension. Much of that pays for her \$300 monthly drug bills and for nearby Condell Day Center, a senior facility that she visits daily. (More than half of the \$37-per-day bill is footed by the state of Illinois.)

Should Evelyn's health worsen, the O'Neils' long-term financial security would be jeopardized. They can borrow against the \$10,000 cash value of their life insurance, or worse, tap into the \$120,000 accumulated in retirement savings. John's pension, which he'll receive at 62, is worth \$40,000. He hasn't decided whether to take that in a lump sum or an an-

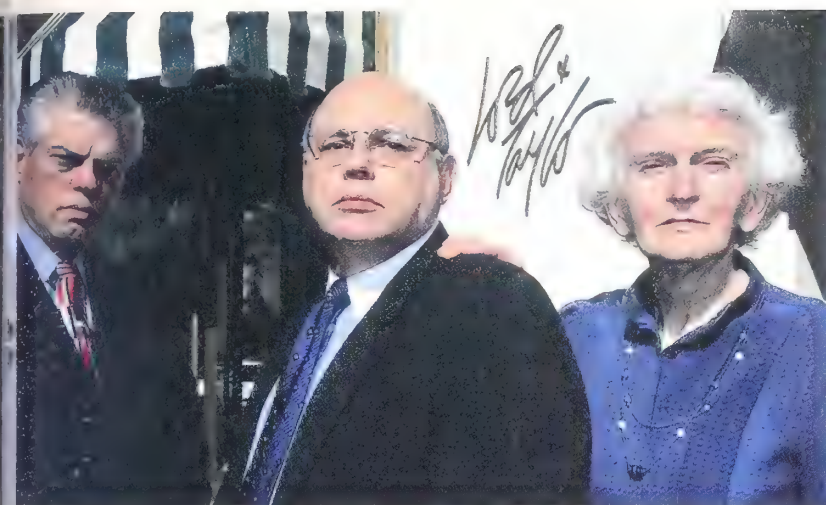
nuity. The O'Neils, who are paying off \$120,000 on their \$210,000 home, fret about when Grandma needs more tending than the day-care center can provide. Full-time nursing home care would cost up to \$4,000 per month. Premiums on long-term care insurance are too expensive for Evelyn, but Gail is investigating a plan for the couple when they reach retirement age.

For now, the O'Neils are coping. They wisely set up mutual funds to pay for college costs. Rebecca's annual room, board, and tuition at Illinois State University is \$10,000. They also took the advice of Jack Dunk, a senior financial adviser at American Express, who told them 10 years ago to combine their insurance policies into one to avoid duplicate fees. He also encouraged them

to save through Abbott's stock purchase program, which matches the first 2% put aside annually, pretax. John estimates the matching added about \$2,500 a year to his savings.

However, with most of their retirement portfolio in Abbott stock, the O'Neils are placing a lot of faith in the continuing success of Abbott, whose stock price has climbed 322% in the past decade. Presently, there's little spare cash. Says Dunk: "For the sandwich generation, the dollars usually flow out and the future is on hold." And for Gail and John O'Neil, dining out is a pleasant memory.

By Lisa Sanders in New York



■ **ON CALL**
*"Pension
 detectives"
 Holzman and
 Engerman help
 clients such as
 Burton recover
 their full benefits*

Companies use a shorter life expectancy for workers over 65, which reduces the number of years benefits will be paid once the employee retires. Because Burton was not properly notified, her benefits were restored. The May Department Stores Co.,

which owns Lord & Taylor, says it is trying to identify other employees who might be owed pension money.

"TRUST, BUT VERIFY." It's difficult even for financially savvy folks to figure out if they are getting their full share. No government agencies exist to investigate—and recover—individual claims. Your best bet is either a pension attorney, who will bill you for expenses and about one-third of any money recovered, or a benefits detective firm. "Trust, but verify" advises Senator Charles E. Grassley (R-Iowa), chairman of the Senate Special Committee on Aging.

If you suspect your pension payout is incorrect, you have six years from your first payment to investigate. First, make a written request for a summary of the plan and all the variables used to calcu-

YOUR PENSION ALL IT SHOULD BE?

all procedural errors have resulted in enormous losses

or nearly 38 years, Ginny Burton crunched numbers at Lord & Taylor's Manhattan department store. Then, in 1993, her bookkeeping job phased out and she retired. When left, she received her retirement funds in a lump sum of \$110,000—a sum she didn't think to question until she was referred to the National Center for Retirement Benefits Inc. (NCRB) at 800 666-1000.

The Northbrook (Ill.) company reviews plans from pension, 401(k), and profit-sharing plans. If NCRB discovers an error, it can recover up to 30% of any money it recovers. There was no upfront fee, Burton said there was nothing to lose. "Most of the time, nothing is better than zilch," jokes Burton, now 73. Through the sleuthing of founders Paul Holzman and Allen Engerman, who refer to themselves as pension detectives, a year later, Burton received an additional \$60,000.

Since 1993, while most of the 45 million Americans covered under pensions take a lump-sum payout they receive upon retiring or changing jobs is correct, there is mounting evidence that they shouldn't. In 1993, the founding NCRB in 1993, ex-Internal Revenue Service agent Holzman and Engerman, a former Chicago prosecutor, have recovered millions from the pension plans of such companies as Frito-Lay, Continental Airlines, International Paper, and Times Mirror. Half of the pension payouts NCRB investigates re-

sult in more money for employees.

Mistakes are almost inevitable, considering the complicated calculations used to determine benefits and the constantly changing pension and tax laws. Intentional fraud is rare, say pension actuaries and attorneys. The bulk of errors result from simple miscalculations or other administrative mistakes such as using inaccurate compensation or employment records, says Brian Graff, executive director of the American Society of Pension Actuaries. But little mistakes can cause big problems. NCRB found that incorrect interest-rate assumptions had shortchanged 7,130 GTE employees to the tune of \$18 million.

Employees such as Burton, who work past retirement age, are especially vulnerable. Burton's employer failed to inform her that working longer might have a negative impact on her pension benefits.

RETIREMENT GUIDE

late your benefits. Keep a pension file, including a list of all employers, dates of service, and benefit and earnings statements, suggests Judith Welles, director of communications at Washington-based Pension Benefit Guaranty Corp., which insures defined benefit plans. For a description of your pension rights, contact the Labor Dept.'s Pension & Welfare Benefits Administration (800 998-7542).

Proposals are before Congress to simplify understanding retirement plans. For now, Engerman cautions: "Don't assume that just because it is a large sum of money, it is the correct sum of money." That can be a costly assumption.

By Kerry Capell in New York

OTHER RETIREMENT RIPOFFS

CONSTITUTIONAL OR COMMON LAW TRUSTS This illegal estate-planning scam is sold to seniors under the guise of asset protection and estate- and gift-tax avoidance. It has become especially problematic in Florida.

DESIGNER ESTATE PLANS Some large accounting firms offer comprehensive estate-planning services for thousands of dollars. But most people can get all the guidance they need from an estate-planning attorney for far less.

LIVING TRUSTS Set up so heirs can avoid probating a will, these trusts are being peddled to people who don't need them. Also beware of prepackaged versions: They can be declared invalid if not in accordance with state law.

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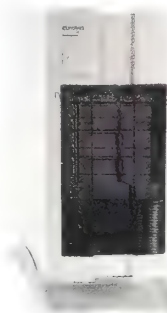


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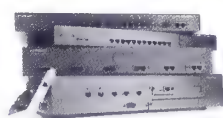
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FOR THE GOOD LIFE, HIT 'ENTER'

Software and Web sites can help you plan for retirement

Who doesn't dream of a comfortable retirement spent combing tropical beaches or schussing down the slopes of Aspen, Colo.? But for many Americans, those dreams won't become reality: Merrill Lynch & Co.'s latest retirement index suggests that the average Baby Boomer

RETIREMENT GUIDE

will need to nearly triple his or her rate of savings to maintain their current standard of living in their twilight years. If you'd like to see where you stand, there are a number of software programs and Web sites that can help provide a quick snapshot of your retirement outlook.

Chances are, a retirement-planning program already is under your nose: Most of the popular home-budgeting programs, like Quicken, Microsoft Money, and Managing Your Money, contain

simple retirement calculators, and the Internet is full of Web sites sporting similar fare. But most of the budgeting programs and Web-based calculators are limited in scope, often overlooking such critical considerations as taxes. To do some serious planning, fork over a few extra dollars for a dedicated retirement-planning program, such as Quicken Financial Planner or RetireReady Deluxe. By analyzing your investments, income, spending patterns, and other criteria, these programs can help determine if your nest egg will be enough to carry you through the golden years. If not, they will suggest a savings plan to help you meet your goals.

Be forewarned that for all the improvements to retirement software in recent years, you shouldn't take their findings as gospel: For instance, too many programs don't explain the critical assumptions underlying their computations, such as those that go into determining life expectancy and tax rates.

This makes it hard to determine whether they are being too rosy or excessively conservative. Still, the programs can help give you an enhanced sense of whether you will need to consult a professional planner.

The best program for Baby Boomers—for whom retirement is still years away—may be Quicken Financial Planner (QFP). While other programs simply calculate how your nest egg will be come your birthday, QFP allows you to build a comprehensive "life plan" projecting annual income, savings, and expenses now until your 125th birthday. QFP is one of the few programs that allow you to compute your income and retirement benefits separately from those of your spouse. QFP factors in other midlife expenses, too, such as the cost of your kids' college tuition will eat into your savings.

SAVVY. For all its strengths, QFP has some inexcusable flaws: The program assumes today's thirty- and forty-somethings will receive full Social Security benefits at age 65, but that's not so. Current law bumps the retirement age up to 67 in coming

decades. And while QFP offers advice on diversifying your nest egg between stocks, bonds, and other assets, it takes an unconventional approach: Rather than make recommendations based on your age and circumstances, it asks what return you expect to achieve on your investments. Give a low-ball figure, say 6%, and QFP will recommend a portfolio designed to earn 6%, mostly bonds. For most savers, that's bad advice.

If, on the other hand, retirement is either at hand or happening, Vanguard Retirement Manager may be your better bet. Designed by the folks behind the Vanguard funds family, the program was created to help current retirees keep track of their cash flow and assets. The program's real strength, however, is the ease with which it handles such prickly issues as minimum required distributions: For that, Vanguard provides calculators that show how each of the different methods of determining the required minimum distribution would affect your tax-deferred account.

As good as both these programs are, they provide so much hand-holding that they'll slow down more sophisticated users. If you're the financially savvy type who just wants to experiment with different retirement scenarios, you'll probably be happier with Price Waterhouse's Retire Secure. The program is just what you would expect from a Big Six accounting firm: The help screens are full of legalese, and the graphics are flat. Still, Retire Secure's calculators provide the best combination of

— Schwab's advice to investors —

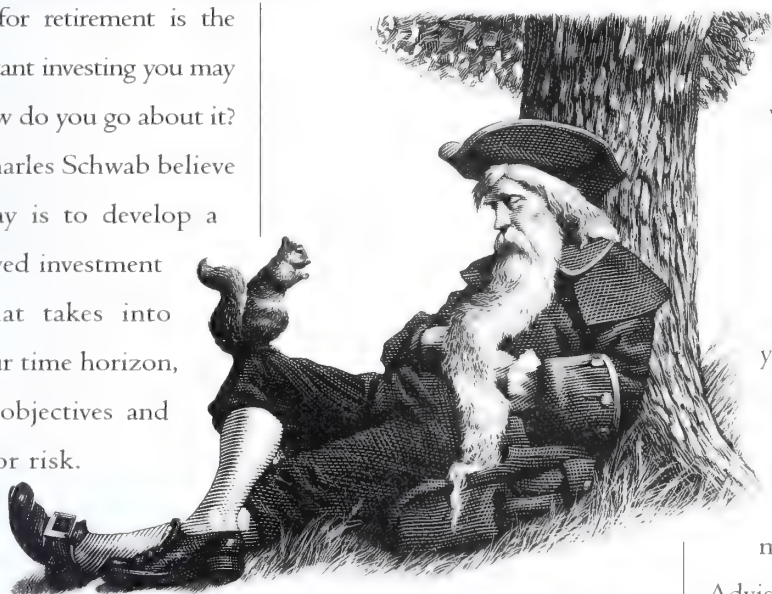
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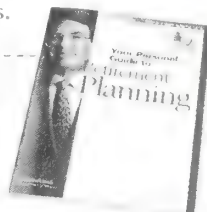


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power and flexibility—making it easy to run countless “what if” exercises. While you’re calculating your retirement picture, you can also use Price Waterhouse’s companion program, Survivor Secure, to determine whether your insurance, savings, and other assets will

RETIREMENT GUIDE

be enough to provide for your loved ones should you die unexpectedly.

LONGEVITY. If your problem is that you don’t know a 401(k) from a 403(b), you should consider RetireReady Deluxe. While RetireReady’s interactive calculator is too basic for most users, its real strength is the wealth of information it provides: Available only on CD-ROM, the program includes a multimedia tutorial that demystifies such issues as reverse mortgages and how Social Security benefits are calculated. RetireReady also provides an extensive database, including the addresses and phone numbers of hundreds of government and private resources serving retirees. And the program, with a built-in browser, provides links to hundreds of other retirement-related sites on the World Wide Web.

For better or worse, most of these programs posit a set of conservative assumptions, such as 4% inflation (above

the current trend) and 7% investment returns (well below Wall Street’s recent performance) that could cause you to overestimate your savings needs. T. Rowe Price Associates Inc. takes a different tack with its new Retirement Planning Analyzer. Price worked with the Washington-based Tax Foundation, a policy organization, to come up with effective tax rates for future retirees that are perhaps more realistic, and certainly lower, than assumptions used by other

Then there are the many free retirement resources on the World Wide Web. You’ll find dozens of retirement-related sites—many the handiwork of financial services firms wanting to sell you a variable annuity or mutual fund—that offer retirement calculators and primer help you determine if you’re on the right course. InvestorGuide’s Retirement Planner (www.investorguide.com/retirement) offers links to about two dozen plan calculators, including one from N

■ *Three of the best sources for information on retirement planning are the Web sites of Vanguard, the AARP, and the Social Security Administration*

programs. And while other programs treat all your contributions to a 401(k) the same, the Price program does a better job of segregating after-tax contributions. The bottom line: Using the T. Rowe Price program may give you a smaller estimate of your future savings needs. But in retirement saving, more is always better. And given Americans’ growing life expectancy and the shakiness of Social Security, if you can do without the current income, you’re better off taking a more conservative posture.

western Mutual that calculates your life expectancy. Be aware that some calculators are so simplistic, they even factor in government limits on contributions to a 401(k) plan.

Three of the best sources for general information on retirement planning are the Web sites of Vanguard, the American Association of Retired Persons, and the Social Security Administration. “Vanguard Online University” (www.vanguard.com) offers primer on such complex issues as the tax col



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ons of cashing out of a 401(k),
, or Keogh plan. The AARP Web-
(www.aarp.org) offers tips on fig-
ing your retirement and lists other
oft groups that serve seniors.
is, amid congressional concerns
security, the Social Security Ad-
ministration has suspended a service

allowing you to order a detailed benefits
estimate online. But there's enough info
to warrant a Web-site visit: The SSA
(www.ssa.gov) provides online access to
more than 600 of its documents, includ-
ing *When You'll Get Your Benefit*.

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er only a portion of your retirement

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401(k)s you manage yourself. As a re-
sult, early planning is more important
than ever. Using a software program
can help ensure that your retirement
years will be spent in style.

By Dean Foust in Washington

RETIREMENT PLANNING BY PC

NAME / PHONE	COST	FORMAT	COMMENTS
QUICKEN FINANCIAL PLANNER Intuit 800 446-8848	\$40	Win 3.1/95 disk, Win 3.1/95 CD-ROM	Best buy for Boomers. Lets you make year-by-year projections of income and expenses from now until age 125. Also lets you figure income and retirement benefits for you and your spouse separately.
READY DELUXE Individual Software 822-3522	\$49.95	Win 3.1/95 CD-ROM	So-so calculators. Real strengths: multimedia tutorials for retirement, topics A-Z. Also includes addresses and phone numbers for hundreds of private and government agencies.
RE SECURE Waterhouse 422-5579	\$45	Win 3.1/95 disk	What you'd expect from CPAs: jargony help screens and dull graphics, but calculators so robust that a pro would use them.
RETIREMENT PLANNING ANALYZER The Price 541-5760	\$20	Win 3.1/Win95 disk	For \$20, good value: Not as thorough as the Quicken Financial Planner, but better at determining future tax rates and distinguishing tax-deferred from taxable accounts. Results: You may need less savings than you think.
GUARD RETIREMENT PLANNER Guard Group 999-1529	\$25	Win 3.1/95 disk, Win 3.1/95 CD-ROM Macintosh disk & CD-ROM	The pick for seniors. Handles with aplomb such prickly issues as minimum required distributions. Comes with 300-page book, <i>Investing During Retirement</i> .



By JACK PATTERSON

10 YEARS ON THE OUTSIDE

You've made it through the office farewell party, and Retirement Day has come and gone. Now, you have no job to go to, no morning coffee break with co-workers, no business lunches, no tough-but-familiar routines to give your day shape and

RETIREMENT GUIDE

purpose. You're on your own. What do you do next?

A week after that day 10 years ago when I said goodbye to my 32-year career as an editor at *BUSINESS WEEK*, I flew off to live in Madrid as a freelance journalist, something I had longed to do for years. That move opened what has turned out to be a decade of mostly satisfying, trouble-free retirement.

Luckily, I did not retire either to escape from a job I hated or to pry myself loose from one I didn't know how to live without. I enjoyed my work most of the time, but I knew the day would come when I would give it up. So I spent many preretirement hours thinking about what I would do when I had cleaned out my desk for the last time. It turned out that in important respects, what I wanted—activities that fulfilled me—was not different from what I had while working.

After 18 months in Spain, I returned to New York and settled into a daily routine of four hours in front of a computer. I exchange E-mail with my sons and a few friends and occasionally surf the Web. But mostly, I slog away at a historical novel about Spain. As a friend of mine comments, the real trouble with retirement is that you never get a day off.

Early on, I resolved to try to do at least one thing a day to make myself feel good. Fortunately, through a combination of pension, investments, and Social Security, I left my job with enough money for my needs, plus a little more for wants. So I allow myself plenty of time for eating out with friends. I've gotten closer to my family. I read fiction, listen to classical mu-

sic, make treks along the fascinating streets of Manhattan. I regularly force myself to climb onto my cross-country ski machine. I spend several months of the year in Paris, London, Madrid, and Berlin. I try—with limited success—to use time with a sharper sense of its fleeting preciousness.

For me, retirement has meant reasserting continuity rather than wrenching change. Of course, many things are different. But on the day after I retired, my life was still my life, and I still faced the responsibility of making whatever I could of it.

To do that, I could no longer count on the discipline and the support system of a job. But I had acquired a

you to fall back on your own resources, intellectual and emotional as well as financial. These have to be cultivated over time, not in the week following your last day at work. And they must be interests that matter. I doubt people who have handled responsible jobs will be happy just taking water aerobics classes or learning to cook Chinese. Some of that is fine but you probably will require more substantial fare—activities that answer a need to be useful and committed, such as volunteering in a community program or learning to read Homer the original Greek.

THE TRICK. Have I made my retirement seem all beer and skittles? It's not. For one

thing, it suddenly alters how people treat you. I've noticed that former colleagues and friends ask my opinion less often and show far less interest when I tell them anyway. Others behave as though I have vanished down a black hole. Does this hurt? A

T.E. Lawrence replied when he held his hand over the candle flame: "Oh, hurts, but the trick is not to care."

Finally, I remind myself that though my efforts make a difference, my retirement depends on a lot of luck. My health, for example, has held up pretty well. But I've read that the first decade is usually the smoothest. After that, health problems can multiply. I will be entering that second decade soon. Aging, I've learned, brings new aches and pains, as well as regrets and dark thoughts of mortality. Of course that's not just retirement. It's the human condition.

But hey, who's complaining? It's back to the PC for few hours, then a modest lunch, possibly a nap, more time at the computer, then dinner with friends. Do I miss going to the office every day? What do you think?

Jack Patterson retired as editorial page editor of BUSINESS WEEK in 198



I try—with limited success—to use time with a sharper sense of its fleeting preciousness

number of intangible assets over the years. I had strong interests—in travel, languages, history, books, and music. They added richness to life before I retired, and I knew I could count on them later. I also brought a feeling of satisfaction and modest achievement carried over from my former job. That surprised me. But it makes sense that people who feel good about what they have accomplished stand a better chance of repeating the experience in retirement than those who leave their work smoldering with disappointment and resentment.

As I'd suspected, retirement forces

CLOSE-UP F CORNING

he home-wrecking company in a new book, but improving



meeting with top executives] I had the people I worked with want better balance between work and y. I got it right between the eyes. blew up at me: "Don't ever bring balance' again! Everyone in this any has to work hard!"

—An "Amerco" junior manager

rom 1990 to 1993, sociologist Arlie Russell Hochschild plumbed the pseudonymous Amerco, a large, profitable technology company well n for its progressive human res- es policies. Granted extraordinary s, she met with 130 employees at vels. The result: Her recent book, *The Time Bind*, a compelling, damning sment of so-called family-friendly egies.

spoil the secret, Amerco is, in fact, ing Inc., according to numerous and present company executives. er Hochschild nor Corning would ent on Amerco's identity. But oth- ay that "Spotted Deer," the book's ide small-town setting, is Corn- Y. And the "much admired" chief tive officer, a great-grandson of nder, is James R. Houghton, who

retired from the company last year.

Many who were at Corning in the early 1990s say Hochschild's depiction of a workaholic environment that yanked people away from their families is dead n. "It was real," says one consultant to the company at the time. "We had discussions on it at every [employee] session. Local managers just hadn't bought in." Observes a former executive: "There was an honest effort to do some-

"AMERCO" REVISITED

Amerco in The Time Bind is, in fact, Corning. Yet the company has changed since Arlie Russell Hochschild's study:

"AMERCO," 1993

Long hours are *de rigueur*; managers equate 60-hour workweeks with performance and dedication.

Many line managers, worried about disrupting operations, resist progressive work-life policies.

Turnover among women employees is far higher than among men; the "glass ceiling" is clearly visible.

thing about [work-life balance]. But was it as successful as all the awards would make us out to be? No."

Four years isn't long enough to transform any culture entirely, but today, Corning doesn't quite match Hochschild's harsh picture. Although the environment remains as intense as ever, employees report that supervisors are more sensitive to family issues and that flexible work arrangements are on the rise. "Widespread" might be too strong a word right now, but it's more common," says one manager. The old perception that longer hours brought better results has waned, too: "Bob is able to say, 'I'm going to be home for dinner with my family,'" says Pam Walker,

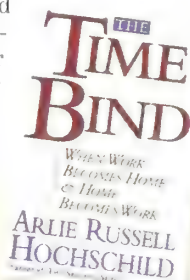
whose husband is a sales representative.

HANGING WITH THE KIDS: The \$1.2 million day-care center

Since Hochschild's study, Corning has spent \$1.2 million to build a day-care center

for 143 children. More important, it began this year to include diversity measures in figuring bonuses for 150 senior managers. And all 2,400 managers will be required by 1999 to take a new nine-day training program featuring diversity and work-life modules.

FLEXIBLE. Such measures may have sold more managers on policies that give workers more time with their families. In *The Time Bind*, one couple madly juggles presentations at work with a child who must be hospitalized. By contrast, Enolia B. Foti recently took a week and a half off from her job as an information technology project leader when her husband had a serious accident, and another week when her young son had surgery. "This company demands a



CORNING, 1997

An intense environment remains the rule, but emphasis is shifting to productivity from sheer hours.

Training and relentless communication seem to have softened opposition—but not in all operating units.

The attrition rate for women, at 8%, has declined, but still is nearly three times that of white males.

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S I N C E 1 9 7 8

Social Issues

be of you," she says. "But when it comes to family and personal time, it's a different story."

Margaret Faber, a 38-year-old research scientist, took more than three months' leave when her first child, born two years ago, then eased back into full-time work over the next six months. Still, she has climbed the ladder and now supervises five other scientists. In contrast with Hochschild's job-conscious parents, she and her husband, Dawes, also a Corning researcher, cut back on travel and work schedules to 25-hour shifts to shorten their mother's time in day care; both visit the child-care center at lunchtime daily.

Yet Hochschild's central finding remains largely true: The vast majority of Corning employees still choose to work hard on work hours. At Amerco, wasn't prepared for the degree to which working parents have forced them to adapt to an unchanged world, says Hochschild, a professor at the University of California at Berkeley. "The explanation is: Parents enjoyed themselves and felt more on the job. 'In a cultural context between work and home...the work is winning.'"

That phenomenon, Hochschild argues, imposes greater strains on workers' families. It may help explain why Amerco was losing women employees in 1990 at a far greater rate than men. That hasn't changed: Last year, Corning's attrition rate among women was 8%, vs. 3.1% for white males. (Both are low by U.S. corporate standards.) **RESISTANCE.** Despite Corning's attempts to improve work-family balance in its corporate strategy, some middle managers still don't support family-friendly policies. "Some of my people, they put families first and their work second," complains one. "In today's marketplace, you just can't compete that way." Edwin O'Brien, a proponent of work-life balance who heads human resources at Corning's communications sector, says, "The time we drive change, initially it's always a disconnect between belief and where we want people to go."

In that regard, Corning is little different from most companies, many of which have addressed the tensions Hochschild studied. Isolated in western New York, Corning's workers face unique challenges: "One reason I worked so hard was there was no one else to do," half-jokes Susan B. Korman, former senior executive. But progress is evident at "Amerco." Written to the *Time* magazine, might be a different story.

By Keith H. Hamer
in Corning

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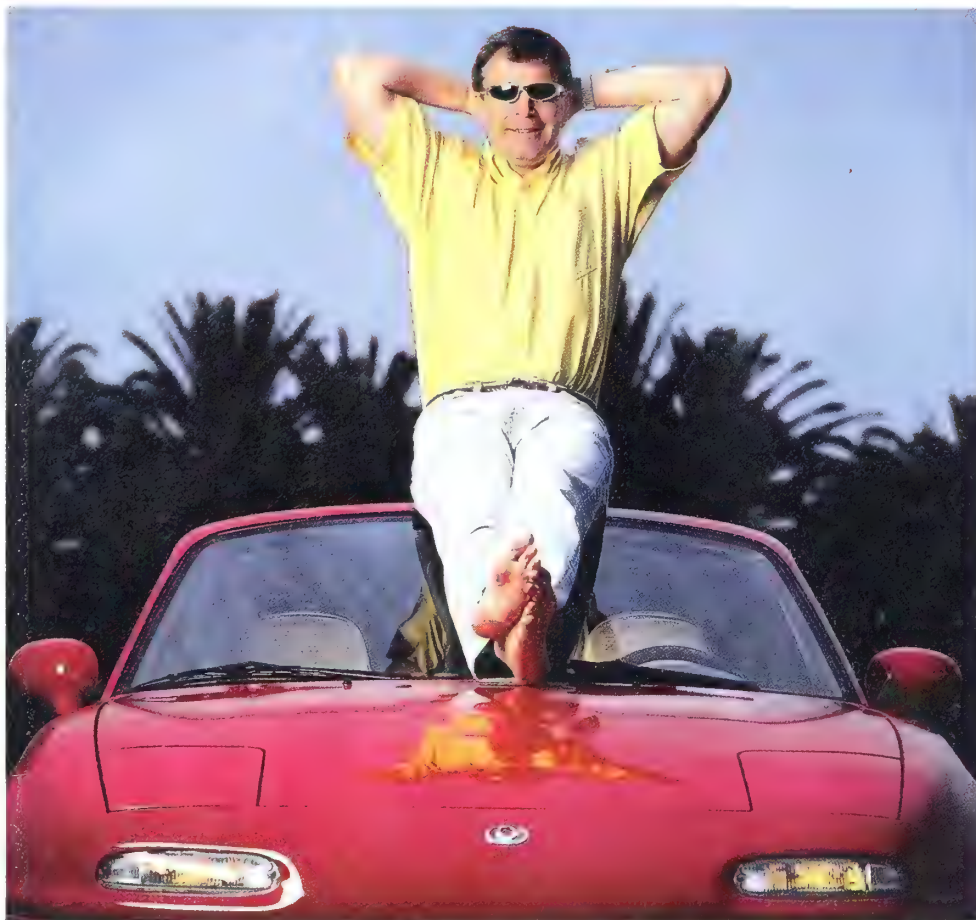


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STRATEGIES

THE STRUGGLE FOR MAZDA'S SOUL

Is the carmaker mapping its U.S. recovery plan—or is Ford?

Just five years ago, Mazda Motor of America Inc. was on a roll. Dizzy with the instant success of its Miata and flush with new products, the U.S. unit of Mazda Motor Corp. believed it could finally take on the Japanese Big Three—Toyota, Honda, and Nissan. No matter that Mazda had always ranked a distant fourth in the U.S., with some 3% of the market. The company was moving up fast. Mazda had even planned a luxury brand, Amati, to compete with Toyota Motor Corp.'s Lexus and Nissan Motor Co.'s Infiniti.

The tide turned quickly. In late 1992, an imploding Japanese economy forced

the Hiroshima-based auto maker to fold Amati before it opened one dealership. A rising yen and booming development costs meant that most of Mazda's new products, such as the MX-3 and MX-6 sporty coupes, became too costly for its core U.S. customer. They were scrapped, along with the 929 family sedan and Mazda's legendary RX-7. Last year, the company sold 238,285 cars in the U.S.—nearly one-fourth of Mazda's total, down 30% from 1992. Responding to the trouble, in April, 1996, minority shareholder Ford Motor Co. spent some \$481 million to up its stake in Mazda from 25% to 33.4%—taking control of

NO JOYRIDE

Beattie has to weed out weak dealers—many of which sell fewer than 10 Mazdas a month

Mazda under Japanese

Ford's choice to pull Mazda out of its rut in the U.S. is Richard N. Beattie, a 24-year Ford veteran. The first American head of the U.S. Mazda, he became president of Mazda's American operations in March of his new position. "Mazda has really lost its way," says Beattie. "We're going to restore Mazda's unique image." The plan: reinvent Mazda, based in Irvine, California, to its U.S. roots as a maker of sporty, affordable cars—and reverse the red ink at the company, which lost \$141 million in 1995, \$15.2 billion in sales, in the year ended Mar. 31. The U.S. Mazda was about \$8 million in the red. Stephen Volkmann of Mazda's Stanley, Dean Witter, Disick & Co. He thinks that the company will hit \$16 million in fiscal 1998. Making Beattie's turnaround task even harder is Ford's attempt to preserve

image of Mazda as an independent Japanese company despite the U.S. automaker's increasing involvement.

NO BOUNCE. Beattie, 42, earned his stripes by helping to turn around the Jaguar unit, where he was vice president for U.S. sales and marketing from 1993 to 1995. He "has the courage and confidence to break new ground," says Michael H. Dale, president of Jaguar Cars North America. He has clout. On May 16, he merged five Mazda American subsidiaries reporting to the parent into one U.S. and one Canadian unit reporting to him. In late May, Beattie was named a managing director of the parent. Unlike his predecessor, he now reports directly to Mazda's president Henry D.G. Wallace.

Clearly, Beattie has a lot on his mind. In October, car buyers will see Mazda's all-new 626 sedan. Early reports are mixed, and it faces stiff competition from such as the top-selling Toyota Camry and a new Honda Accord. "That's the problem is not for the faint of heart," says Paul Ballew, chief economist at consulting J.D. Power and Associates. "The [cars] are not only good but they are increasingly very aggressively priced. It is highly unlikely that Mazda

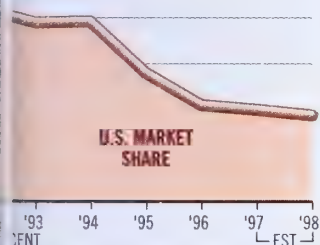
at a bounce from the 626." That
pell trouble. In '96, the 626 made
of U.S. unit sales.

in the works is a brand over-
New products will sport a new
along with an advertising cam-
that revives Mazda's reputation
n car at a nice price. But Beattie
as problems with Mazda's nearly
alers: More than a third sell un-
vehicles a month. Last year, a
Mazda dealer sold only 264 ve-
Toyota dealers averaged 906.

UP OR... Beattie admits that
g sales have forced dealers to
their Mazda franchises into those
thier car lines. But now he's get-
ugh. "We are overdealed," he
and our good dealers need us to
ction with the weaker ones."
wants them either to shape up
out to stronger Mazda dealers,
says he'll get rid of laggards.
ite franchise laws protect dealers,
ttie may have to pay a steep
o clear them out.

not Beattie's first revamping of a
network. He did the same thing

MAZDA SPINS ITS WHEELS



RD'S AUTOMOTIVE REPORTS, J.D. POWER & ASSOCIATES INC.

uar, whose dealers—like Maz-
posted poor customer-service
"He is not the glad-handing,
u-on-the-back type," says Frank
arso, a Jaguar dealer in Union
Del. "He wanted the dealers to
mplaining, come up with realistic
oals, and do a much better job of
er satisfaction."

ord has its way, some of Mazda's
links could be replaced by Ford
oms. In a radical experiment that
s proposing in Salt Lake City,
zda dealers would fold into Ford-
superstores that would carry
Lincolns, Mercurys, and Mazdas.
ts say the plan, along with Ford's
o merge its production with Maz-
ows a change in attitude. "Ford
passionately embracing Mazda,"
Christopher W. Cedergren, man-
director of consultant Nextrend in
und Oaks, Calif.

may be hard for Mazda loyalists



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to swallow. The proposal implies that Mazda could become just another "brand"—in sharp contrast to Chairman Alexander J. Trotman's statement at the May annual meeting that he wanted "completely separate Ford and Mazda brands." He was responding to a letter from Yamamoto, a Hiroshima investor who had flown in to express fears of Ford's growing power. "It felt like being hit by another atomic bomb when Ford acquired 33% of Mazda," Yamamoto said.

Already, the lines are blurring.



HEAVY METAL: Mazda is sprucing up its image with a new logo

originally planned to design the full-line volume products and let Mazda handle the niche markets, such as the luxury cars. But now, it's looking to Mazda for fuel-efficient cars. Insiders say Ford has halted development of its own sport-utility vehicle in favor of a license version in the works. They also say Ford will base its next-generation car on Mazda's next 626. Ford often won't reveal details of future product-sharing plans and attempt to downplay their growing control of Mazda. In fact, Ford Vice-Chairman W. Wayne Ford, who oversees the Mazda investment, declined to be interviewed for this article.

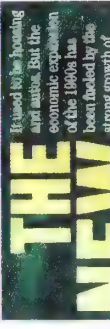
STILL JAPANESE? Merging the companies' production plans may not be a work to Mazda's advantage. With the new mini-sport-ute, which Ford will build, Mazda has been allotted only 30% of the estimated 200,000 vehicles produced per year, despite having designed it. Says George Peterson, president of consultant AutoPacific Inc. in Santa Ana, Calif.: "It's right for Ford, but not for Mazda."

Ford says it is obliged to maximize both companies' shareholder value. Now Beattie must turn Mazda around while appearing to steer a course independent of the big Detroit competitor. He must convince car buyers drawn to reports that Mazda is still Japanese—not just another Ford offshoot.

By Larry Armstrong in Irvine, Calif., with Keith Naughton in Detroit and Emily Thornton in Tokyo






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DIZZYING NEW WAYS TO DICE UP DEBT

Suddenly, credit derivatives—deals that spread credit risk—are surging

In June, an international bank client of J.P. Morgan & Co. called the august Wall Street firm with a not-uncommon problem. It had a basket of some 20 loans totaling more than \$500 million to mostly investment-grade companies but wanted to lend more money to the same borrowers. And it wanted to reduce its capital requirements and protect itself against borrower defaults. In the past, Morgan's client would have had to sell all or part of the loans.

Not anymore. For a fee based largely on the credit quality of the borrowers, Morgan sold the other bank, which it declines to name, the right to require Morgan to pay off any of the loans if a borrower goes bankrupt. Morgan can either retain the default risks in its portfolio and collect the fee, or sell them piecemeal to a growing cadre of institutional investors that includes insurers, hedge funds, and other banks. Meanwhile, Morgan's client retains the actual loans and the customer relationships.

Welcome to the little-publicized but rapidly expanding new world of credit derivatives, the infant cousin of better-known and occasionally notorious financial derivatives. Besides credit-default swaps, a kind of guarantee that can be bought and sold, permutations include

total-return swaps—which enable lenders to sell the cash stream of a loan but not the loan—and options on credit risk. Boosters say credit derivatives could alter for the better the credit-risk profiles of financial institutions and companies. By enabling lenders to strip loans, bonds, and other instruments into credit risks that can be privately traded in institutional markets, these contracts, they say, will promote portfolio diversification and reduce loan concentrations.

AVID PROSPECTORS. “The potential for growth is enormous,” says Blythe Masters, global head of credit derivatives at J.P. Morgan, which claims a global market share of about 20%. “They deepen the liquidity with which loans are bought and sold and will help make the pricing of credit risk more rational.” Adds Barry Finkelstein, a director for structured products at Merrill Lynch & Co., credit derivatives “are on everybody's radar screen. It's difficult to be a full-service derivative house without being in the credit-derivative markets.”

Wall Streeters think credit-derivative activity could soon approach the multi-trillion dollar financial-derivatives market in volume and importance. According to estimates, derivatives covering as much as \$150 billion in credit instruments

are now outstanding, up from just a billion or so last year.

That's still minuscule compared to the more mature financial-derivative business, which includes future contracts, and interest-rate and currency swaps. One reason credit derivatives had been somewhat slow to develop was the fear of repeating the disasters that have plagued the financial-derivative business in recent years, such as the Bankers Trust/Procter & Gamble debacle. Indeed, while dealmakers and regulators alike are ebullient about the potential of credit derivatives for dispersing credit risk, they acknowledge that in the wrong hands, these instruments can—and most likely will—cause heavy losses on some banks, companies, and investors. Christine M. Cummins, senior vice-president at the Federal Reserve Bank of New York, stresses that bank regulators view credit derivatives as a “positive development.” But she concedes that the “potential for problems also creates the potential for problems.”

In the absence of a blowup, practitioners seem more focused on the good rather than the bad and the ugly. In the U.S. and foreign financial institutions are eagerly prospecting for business according to the Comptroller of the

A TYPICAL CREDIT DERIVATIVE

One derivative, a default swap, lets investors trade default risks



1 A bank makes a five-year loan for a power plant in China, but doesn't want the risk of default

2 To avoid the risk that the loan might go sour, the bank gets investors to assume the default risk for a fee

3 If the borrower defaults, investors would reimburse the bank for loss in loan value

BENEFITS

- ▶ Promotes portfolio diversification
- ▶ Reduces loan concentrations to individual borrowers
- ▶ Facilitates efficient credit pricing

RISKS

- ▶ Untested in declining economy and rapidly rising interest rates
- ▶ May not be well understood by prospective buyers
- ▶ Can compound credit risk as well as reduce it

DATA: BUSINESS WEEK



Morgan has about three-quarters of U.S. commercial bank volume, followed by Citibank, Chase Manhattan, and Bankers Trust. The comptroller's rules don't include certain types of transactions or the activity of foreign commercial banks and investment banks such as Merrill, another big player. Along with the surge in transactions, sales of these instruments seem to be moving fast. Emerging markets, such as China, are a beneficiary, says J. Gregg Tucker, Chase Manhattan's head of credit derivatives. Many companies and lenders are interested in using them in Chinese businesses but don't want to take on China's country risk. So Chase has sold default swaps that let investors hedge that risk. And, he points out, initial companies have begun to use credit derivatives to cut accounts-receivable concentrations. That way, they reduce credit risk while maintaining customer relationships," he says. The obstacle to expansion is the prohibition of credit derivatives by bank regulators in calculating capital requirements. In most situations, regulators call for banks to put up the same capital against these instruments as

the disasters in financial derivatives. But now, the market approaches some \$150 billion

MASTERS: "ONE-SIZE-FITS-ALL" BANK RULES HAMPER CREDIT DERIVATIVES

they do for the underlying loans. But some practitioners, such as Morgan's Masters, think credit derivatives could ultimately prompt regulators to relax the 10-year-old global-risk-based capital rules. "Credit derivatives suffer from the same one-size-fits-all rules as other bank credit instruments," she says.

Insurers, such as New York-based American International Group, are also becoming major players, though mainly as users rather than dealmakers. The business has "grown significantly," an AIG spokesman said, adding that AIG uses them to hedge credit exposures in insurance underwriting and investing.

These instruments permit institutional investors, for the first time, to buy into syndicated loans to noninvestment-grade companies, and thereby obtain returns higher than those on junk portfolios without junk's volatility. Mark R. Shenkman, president of Shenkman Capital Management, says the firm has invested in total-

return swaps for nearly two years, achieving leveraged average annual returns in excess of 15%. Those transactions typically work this way: A bank originates a floating-rate loan to a company with interest at, say, 300 basis points over the London Interbank Offered Rate. But it actually lends the money to investors like Shenkman at perhaps 100 basis points over LIBOR. They, in turn, fund the company loan, accept default risk, and collect interest and fees. Currently, Shenkman says, the firm holds about 32 swaps for about 25 companies amounting to "several hundred million dollars." Unlike the case with fixed-rate junk, rising rates don't erode loan principal. "As long as you buy good credits, the returns are predictable," he says.

MINEFIELDS. To date, none of these deals has blown up, experts insist. Still, they recognize that the new market isn't without potential minefields. Says E. Gerald Corrigan, managing director of Goldman, Sachs & Co. and a New York Fed expert: "The unbundling of credit risk probably should be a good thing, assuming that people picking up the elements of credit risk understand what they're doing and the risks they're incurring."

Just as bankers have gotten burned by making bad loans, they could stumble by buying poorly structured credit derivatives. And deals may fail to allow

Credit derivatives got a slow start because of

for a spike in interest rates or an economic downturn. Corrigan and others are concerned about the reliability of models used to measure potential credit risk and set transaction prices. Tanya Styblo Beder, principal of Capital Market Risk Advisors, warns that risk models based on historical default data could prove invalid for credit derivatives linked to syndicated loans. Michael L. Brosnan, director of treasury and market risk at the Comptroller of the Currency, says that while credit derivatives are a "big plus," there are "going to be banks that won't use them wisely." Insurance regulators are taking no chances. In June, the National Association of Insurance Commissioners launched a study of insurer exposure.

For now, practitioners can only hope that when it comes to credit derivatives, Murphy's Law doesn't apply.

By Phillip L. Zweig in New York

GOLD ISN'T WORTH ITS WEIGHT IN GOLD

With inflation at bay, central bank sell-offs are bashing investors

Jean-Marie Eveillard isn't throwing in the towel just yet. But with gold down almost \$100 an ounce since early 1996, the So-Gen Gold Fund manager is obviously disappointed. "I'm a patient investor, but I've said that if a sustained move in gold was not in place by late 1998, that I would write shareholders a letter suggesting they redeem shares," he says.

Eveillard may want to start drafting that letter. As the yellow metal is slammed by central bank selling, the goldbugs of the world are getting squashed. With inflation nowhere in sight, a new generation of central bankers and private investors see gold not as a store of wealth, but as little more than a nonproducing asset—almost a commodity. And if, as some economists predict, worldwide deflation is in the cards, the rationale for buying gold is thin indeed. "The incessant downward pressure on gold, as well as the Commodity Research Bureau index's decline to a two-year low, indicate that deflationary pressures are mounting," says money manager Joel Unger of Stralem & Co. "If that's correct, there's no reason to buy gold as an inflation hedge."

AUSSIE STUNNER. The latest blow came on July 3, when Australia's central bank said it had sold more than two-thirds of its gold, putting some \$2 billion into U.S., German, and Japanese bonds. By July 7, gold for August delivery had fallen more than \$13, to \$319, and hit \$314 during the day, an 11½-year low. That's a far cry from early 1980, when gold commanded as much as \$850 an ounce. While European central bank selling had been expected as countries gear up for the European Monetary Union, investors were stunned that Australia, a key gold producer, had sold. "People are thinking that it's not just European central banks selling, that it could be any-

one," says Robert W. Radsch, who manages the Lexington Goldfund.

Throughout the year, the strength of the U.S. economy and the dollar have been a real negative for gold. "A strong dollar provided a very attractive return as a store of value," says goldbug Michael Metz, market strategist at Oppenheimer & Co. But for foreigners, gold became more expensive. "The feeling was: So why not be in dollars and get 6%, too?" he says.

Although demand for gold jewelry outstrips mine production, jitters over central bank selling have some analysts predicting gold could drop to \$280 per ounce. Prices are so low that mines with high production costs find it uneconomical to

operate. East Rand Proprietary Ltd. in Johannesburg, for one, is halting operations at its Benoni Mining division. Some goldbugs say if supply shrinks as mines close and demand stays steady, gold could rebound. But central banks have a very upsetting that scenario by selling.

Assets in gold funds are shrinking. Since hitting a high of \$5.7 billion in 1993, assets in the 42 precious metal funds tracked by Morningstar Inc. have shrunk 35%, to \$3.7 billion, as of July 30. Says Robert Adler of AMG, which also tracks fund flows: "The sector is dropping this fast. Investor sentiment is being clearly expressed."

Even investors who bought these funds of top-notch gold mining companies have suffered mightily. While

Standard & Poor's 500-stock index is up 22.5% so far this year,

the S&P's Gold Index, which tracks such well-regarded names as Barrick Gold and Newmont Mining, is down 23.3%. Barrick stock has fallen 26.5%, while Newmont is down 19.3%.

A few contrarians are still to hope. "With talk of the stock market being severely overvalued and yet one hating gold, this looks like a really good time to raise the position," says Ralph Aldridge, who may increase the gold weight of U.S. Global Investor Inc.'s

Shares Fund from the usual 5% to 10%. Lexington Goldfund's Radsch believes that gold is "damn cheap historically," but says "I'm worried it might get cheaper."

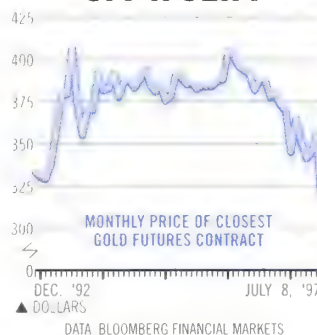
What could lift gold out of its slump? "You could get a short-term spike in commodity funds covering their selling," says Eveillard. Longer term, it would take economic or political turmoil, such as the Europeans being unable to have a single currency in

place, he says. If the market dives, gold may shine. "Just when we're having a technical move in the stocks, I think we're at the end of a sustained move down in gold," says Oppenheimer's Metz. "It's an extraordinarily attractive set." But only for goldbugs or masochists, it seems.

By Suzanne Venkatraman
in New York



OFF A CLIFF



Monday:

Find that expense report from 1993
(the one with the little white lie in it)

Wednesday:

Search through records to
find receipts justifying
penses. Stand in line to
the fax machine. Curse
the AP department

Tuesday:

Sort through 1996
paperwork. File some
documents. Photocopy
others. Recycle the
originals. Repeat
process until desk is
recognizable

Friday:

Organize marketing research
memo and sales projections by
client, product, and quarter

Thursday:

Spend six precious hours retyping
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A new push puts bankers on the front line against dirty money

At Citicorp's annual meeting in Miami on Apr. 9, CEO John S. Reed revealed to shareholders that the bank could be "criminally indicted and convicted" for money laundering. The case stems from the bank's dealings with Raúl Salinas de Gortari, the brother of former Mexican President Carlos Salinas de Gortari.

As startling as the government's probe of Citi may seem, it is just a small piece of a little-publicized but immense initiative that has intensified over the past three years or so to combat money laundering. The effort includes the Federal Reserve, the Comptroller of the Currency, the Treasury Dept.'s **COMPTROLLER** Financial Crimes Enforcement **LUDWIG:** *Drugs are "the heart of the concern"* Network, a 26-nation task force created in 1989 by the Group of Seven industrial nations—and the White House. In an October, 1995, Presidential Decision Directive that got virtually no public attention, President Clinton authorized extraordinary actions against money laundering, including freezing funds in U.S. banks held by suspected Colombian drug dealers.

Much of the campaign focuses on bankers, many of whom traditionally have taken a see-no-evil posture, especially in accounts with many zeros. Now, regulators are working to transform bankers into active informers. A just-completed three-year cycle of prescriptive exams of 40 private banking operations by the New York Federal Reserve Bank showed that "the banks needed an education," reports a U.S. regulator. "We squeezed 'em good." Later this summer, the Fed is expected to issue the first mandatory "Know Your Customer" regulations to ensure that banks are as diligent in spotting questionable transactions as they are in checking borrower credit standings.

"The drug war is the heart of the concern," explains Comptroller of the Currency Eugene A. Ludwig, who on June 20 formed a task force to help produce uniform anti-money-laundering regulations for all U.S. banks. Drug

trafficking constitutes 8% of world trade, according to the latest U.N. statistics. An estimated annual \$300 billion to \$500 billion in dirty money—much of it from the drug trade—currently is being cycled through the U.S. financial system. "We've gotten used to \$20-, \$30-, \$40 million being parked in a bank account for a day and then returning to Mexico,"



CLEANING UP THE LAUNDERERS

WHITE HOUSE Broad anti-laundering mandate, including a presidential directive to block funds in U.S. banks held by suspected Colombian drug dealers

FEDERAL RESERVE Forthcoming "Know Your Customer" rules guiding banks to spot questionable transactions

TREASURY DEPT. Task force to produce uniform anti-money-laundering rules for all U.S. banks by Comptroller of the Currency; new unified system of "Suspicious Activity Reports" on dubious client dealings run by Financial Crimes Enforcement Network

JUSTICE DEPT. Vigorous and wide-ranging pursuit of money-laundering violations

GROUP OF SEVEN Elaborate 40-point program to create anti-money-laundering standards and laws worldwide

DATA BUSINESS WEEK

sighs an anti-money-laundering

The Know Your Customer rule is crucial in enabling bankers to spot suspicious client transactions, says Richard Small, a bulldog Fed supervisor instrumental in crafting the regulatory anti-money-laundering procedures. Banks know who their customers are, says Small, "they should know if the activity isn't normal." The part regulations will require banks to know the ultimate owner of all accounts. "We make vigorous efforts to determine the source of their deposits is legitimate, and analyze the account's payment and transaction patterns so that normal activity can be red-flagged."

SHOCKED. While it's hard to prove the anti-laundering campaign is succeeding, regulators feel bank executives are much more sensitized than

used to be. That shows compliance with a new system of so-called Suspicious Activity Reports bankers must file when they encounter questionable transactions. "We were shocked that as many as 40% of the first 65,000 reports were for money laundering," says Stanley Morris, director of the 7-year-old Financial Crimes Enforcement Network, which has used the reports to add to the 5,000 identified bank accounts controlled by Mexican and Colombian traffickers.

Tougher practices at banks may impede—but not stop—money laundering. The growing volume of laundering—and laundering profits—are being diverted through 160,000 less scrutinized bank financial-services businesses in the U.S. The worst launderers are experts in cyberpayment scams.

Despite the crackdown on growing international corruption, competitive pressures make cases like Salinas' likely to arise again. Admits a private banker, "One of my protocols is to ask who does the private client hang out with? The brother of a president is being acclaimed for all the great things he is doing. But the truth is, we're looking for people like that." That's the attitude the anti-money-laundering officials want to halt.

By Steven Solomon
Washington

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when you hop into the cockpit and feel the leather and
the walnut and the dual-overhead-cam V8 and

anything else you want to feel, you won't be surprised. At

the price, at least. **AURORA**



BY GENE G. MARCIAL

LITTON LIGHTS UP RADAR SCREENS

Aerospace stocks have soared this year, mainly because of a rash of takeovers. But one defense stock has been adrift: Litton Industries (LIT).

"Litton underperformed the S&P Composite in 1995, 1996, and, so far, 1997," says Byron Callan of Merrill Lynch. But

is it time to give up? Not at all, says Callan, who thinks something will ultimately jog the stock. "Either better earnings or a strategic event" could unlock Litton's worth, he argues.

That event could be a buyout. In recent weeks, Litton has perked up from 45 a share to 50.

One investment manager reckons General Dynamics will make a bid for Litton, which he thinks is worth 80 in a buyout. Both Litton, with a market capitalization of \$2.3 billion, and General Dynamics, nearly \$5 billion, need such a deal, he observes, "if they are to survive in the consolidating aerospace-and-defense industry."

Litton is a leader in defense electronics, radar devices, computer components, integrated circuits, avionics instruments, and combat ships.

General Dynamics builds submarines and tanks. The company has been in an acquisition mode: In early 1997, it acquired Lockheed Martin's armament and defense systems, and in 1996 it bought Bath Iron Works and Teledyne's vehicle systems. General Dynamics derives almost all of its revenues from U.S. government contracts. Litton gets 70% of its sales from the government. Litton's goal, say analysts, is to boost the commercial component of its sales from 30% to 50%.

Analyst Joseph Campbell of Lehman Brothers says: "Litton is among the few remaining defense targets." He notes that, despite double-digit earnings growth, continual share buybacks, and acquisitions, Litton is "one of the

cheapest stocks in our universe." Litton's businesses, he adds, are all in leadership positions. The stock trades at a price-earnings ratio of 11.8 on his 1998 earnings estimate. Its peers trade at multiples of 13 to 17.

Campbell, whose estimate for Litton exceeds the Street consensus, expects net earnings of \$3.48 a share for the year ending July 31, 1997, and \$3.90 next year, vs. 1996's \$3.15. Litton and General Dynamics declined comment.

HOW THE STREET IS MAKING HEADWAY

Wall Street is notorious for overhiring in good times and underhiring in bad. Either way, it's good news for little-known Headway Corporate Resources (HDWY), which provides staffing and advisory services to banks, brokerages, and investment firms.

"It's a tremendous market for us, be it bull or bear," says Headway's CEO Gary Goldstein. He finds that Wall Street always needs help in hiring and firing. Outsourcing is the solution.

Headway has been busy acquiring other companies to widen its reach. So far this year, it has acquired five temporary-staffing companies.

Despite Headway's puny size, big institutions have been buying—in anticipation of new acquisitions, which should give Headway a national presence. "Like many micro-cap stocks, the stock, now at 3 3/4 a share, is inefficiently priced, and we think it's worth much more, based on future earnings and potential growth," says Phil Westreich, managing partner at Weston Capital Management. He expects earnings of 30¢ for 1997 and 45¢ to 50¢ in 1998. Headway posted operating earnings of 14¢ last year.

Within weeks, Headway is likely to announce three acquisitions that should push revenues to \$147 million by yearend, up sharply from last year's \$57 million. They are expected to contribute 10¢ a share to this year's earnings and probably more in 1998. Two

(further) other acquisitions are negotiated. Goldstein acknowledges that major acquisitions are in the works.

DIAMETRICS LOOKS MORE RED-BLOOD

When Jim Steiner of Minneapoli Mutual Funds bought Diametrics Medical (DMED) shares at March, he figured the stock was undervalued by 50%. He was only right. The stock zoomed to 9 1/2 in June. By July 8, the stock had set back to 8 1/2, but several investors think the stock will continue to climb.

Christopher Tihansky of General Merchant Group thinks it will hit 10 a year. Why is Diametrics so hot?

"The company will be big in the billion point-of-care blood-analysis market," says Tihansky, who sees the company in the black by 1999, when it expects it to earn 18¢ a share.

Diametrics' first product is a portable blood-gas analyzer. It lets health-care providers evaluate a patient's blood-gas chemistry at the bedside. The operator draws a sample of blood. In 90 seconds, results are displayed on a liquid-crystal screen, with a hard-copy printout. Diametrics' key product, called Paratrend 7, allows continuous monitoring of blood gases.

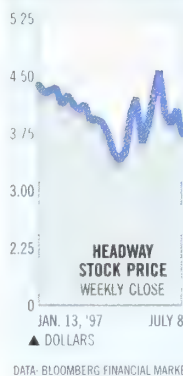
Chiron, a major biopharmaceutical house that has an agreement to market Diametrics' products in Japan, expected to broaden the scope of its alliance. Chiron will widen distribution of Immediate Response Mobile Analysis and Paratrend 7: In Asia, Chiron will market the products in China, Hong Kong, India, Korea, Malaysia, Singapore, and Taiwan. In Europe, Chiron will sell them in France, Portugal, and Spain.

"The potential of the broadened pact with Chiron is tremendous," says one insider. "It not only opens up new markets but also bolsters the Chiron-Diametrics link," he says. The new pact will sustain the growth of sales, he adds.

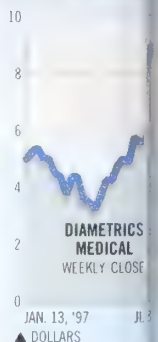
IS A BUYOUT BEHIND THE BLIP?



"IT'S WORTH MUCH MORE"



OPTIMISM ABOUT OVERSEAS SALES



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FORGET THE HUDDLED MASSES: SEND NERDS

A critical shortage of programmers has prompted a worldwide labor hunt

As a headhunter, George Van Derven has an unlikely connection: Russia's former state airline, Aeroflot. Not that Van Derven trades in pilots, flight mechanics, or surly Russian flight attendants. But in a former career, he sold a computerized reservation system to Aeroflot and came to know the talented programmers stashed in the back offices. When Aeroflot broke up into regional carriers in 1992, Van Derven promptly tapped its brain pool. Now, as president of Alternative Technology Resources Inc. in Sacramento, Van Derven is mining a rich lode of programming talent and busily dispatching it to understaffed computer departments throughout the Western world.

Other recruiters should be so lucky. High-tech headhunters for Andersen Consulting tramp through technical schools in Budapest and job fairs in Manila. At a recent training session for programmers in Holland, Microsoft Corp. hired bouncers to keep headhunters at bay. And a recruiter for IBM's Global Services Div., who is trying to hire 15,000 software hands this year alone, introduces himself as James R. Bunch, "as in bunch of jobs."

The Information Revolution is racing ahead of its vital raw material: brainpower. As demand explodes for computerized applications for everything from electronic commerce on the Internet to sorting out the Year 2000 glitch, companies are finding themselves strapped for programmers. In the U.S., alone, which accounts for two-thirds of the world's \$300 billion market in software products and services, some 190,000 high-tech jobs stand open, most of them for programmers, according to the Information Technology Assn.

SOARING SALARIES. That's sending companies scouring the globe for talent—and lifting salaries skyward. A typical programmer's wages, now some \$70,000, is jumping 13% a year, and far higher in the hottest niches, such as Java Internet software and SAP business applications.

These days, \$20,000 signing bonuses are commonplace and stock options are being handed out with as little fanfare as office supplies. If the pace keeps up, experts say, ballooning salaries could wind up damaging the global tech machine as margins are squeezed and investments postponed.

And relief is nowhere in sight. Experts predict the gap between computer-science students and expected demand won't ease for a decade, if then. Too many bright young people, especially in Europe and the U.S., consider programming geek work and choose other careers. In the U.S., the number of computer-science graduates has plummeted in the past

decade or so, from 48,000 graduates in 1984 to an estimated 26,000 this year. "This is a real limiting factor on growth," says Avron Barr, a researcher at Stanford Computer Industry Institute who is investigating the shortage.

Indeed, for high-tech companies, the dearth of program-

CANADA
ty of War
spout of a
programmer

CHICAGO Andersen Consulting hopes to hire 3,500 tech workers off college campuses this year alone and an additional 6,500 elsewhere.

DIGITAL HAVES AND HAVE-NOTS

The headhunter's guide to the world's software riches

COSTA MESA, CALIF.

At Ernst & Young's round-the-clock Year 2000 factory, programmers work a full day in California and then hand off jobs to 7,000 partners in India.

SILICON VALLEY Finders' fees for hires range from \$500 to \$5,000. Signing bonuses reach 25% of salary. Stock packages are rich, too.

DALLAS As it tries to fill 10,000 jobs, Electronic Data Systems hops from continent to continent looking for employees.

ARGENTINA AND CHILE

Pesos are strong, which undermines global recruiters' pitch. Colombian techies, though, are eager to pack their bags.

s the greatest threat to expansion coming year—far more menacing, say, than an economic slump or recession in the marketplace. And it's not a problem for tech companies.

Others are desperate for the talent. Auto makers from Tokyo to Detroit are packing more computing into their cars and plants. Banks, airlines, and phone companies are going to outdo each other with the best online services, all requiring a lot of nerds. Those that choose not to embrace the newest technology, says Corning CIO Michael Radcliff, "are creating a competitive liability."

FRANCE Solid in science and math talent. Good for business applications, much training is required. And applicants aren't strong in English.

BULGARIA Lots of C++ programmers want out, but their English is iffy.

ISRAEL With 800 high-tech startups since 1994, country is short of managers and programmers.

RUSSIA When Aeroflot cut loose hundreds of mainframe techies in Moscow, Minsk, and Kiev, Computer Sciences Corp. swooped in. Many are now in Texas, writing code for insurance programs.

INDIA With 3.5 million graduates in science and technology, India is a brain-power giant. But a study finds that the country is nearly "tapped out."

PHILIPPINES The people love to leave, which is helpful. Great with old technology, such as Unisys mainframes.

SOUTH AFRICA Good with old computers. But many lack degrees, which makes it tough to get papers to work in the U.S.

Of course, if you're willing to pay—or have the stock options to entice—you could be up to your propeller hats in programmers. In Silicon Valley, star programmers are swimming in stock options, driving Porsches, and buying homes in the pricey Los Altos hills. At Netscape Communications Corp., which plans to hire more than 1,000 programmers this year, employees receive up to \$5,000 just for a successful referral and the pampered programmers are treated to onsite massages, teeth-cleanings, and laundry service. The company lines up their 49ers tickets and books their white-water rafting vacations. All

this to keep them from succumbing to a stream of calls from headhunters. "Everybody's going crazy now trying to find these folks," says Margie Mader,

Netscape's human-resources director.

How did the shortage get so bad? For years, tech companies had little reason to fret. In the early '90s, the industry snapped up hundreds of thousands of workers who were dropped into the job market when large corporations downsized—a source now running dry.

TEDIOUS WORK. At the same time, the very act of writing software has not speeded up despite the computer revolution and the terabytes of information hurtling around the globe. Today, even the best of programmers painstakingly turns out some 10 lines of code a day. To whip up today's software programs—even a cellular telephone requires some 300,000 lines of code—takes armies of programmers laboriously writing away. Consider this: There are six million software programmers and counting in the world today, two million of them in the U.S. and one million in Japan. As an industrial model, it's akin to pre-Gutenberg monasteries with their legions of scribbling monks.

For years, global savants pooch-pooched the pending programmer crunch by pointing to India, which boasted a seem-

ingly bottomless reserve of techies. India, they said, would be to software what Saudi Arabia was to oil. And true, with 50,000 programmers pouring out of schools every year—twice the American total—India is a valuable labor pool.

But with global technology bursting to \$3 trillion this decade—four times higher than in the '80s—India's supply simply isn't enough. And no other plentiful source of software skills appears to be on the horizon. Russia has promise, but it's limited: Few of its programmers speak English or understand business applications. China is a possibility, but it's likely to employ most of its programmers over the next decade for its own massive development projects. "I

had this one programmer from China," laments one official at Electronic Data Systems Corp. "I took him through the whole immigration process, got his papers. Then he got a better offer."

RAID BAIT. Naturally, in this world of predators, there's a pecking order. Sitting on top are the fast-growth companies with hot Internet technologies. They're magnets for talented programmers, and they can pad their offers with rich stock options. Service companies such as Andersen Consulting, IBM Global Services, and Ernst & Young, which are helping companies install systems worldwide, are forced to routinely dole out six-figure salaries to programmers with experience in business applications. They compete with countless body shops—outsourcing companies that pay as much as \$300,000 for skilled programmers willing to live on the road.

At the bottom of the pile are the corporate tech departments throughout the world. Many are short on money and stock options. And if they install a popular system, bringing their staff up to date on something new from, say, Oracle Corp. or the German software giant SAP, their departments get raided in no time. Don Yates became familiar with SAP's leading software package for business while helping install the system in the early '90s at Royal LePage Ltd., a real estate company in Toronto. Within a year, the 18-person department was picked clean. "I was the last one to go," says Yates, who now makes three times as much money, some \$150,000, as an itinerant programmer for EMI, a Pittsburgh-based company that rents out software talent.

No surprise, then, that companies are trying any tactic, including turning to the World Wide Web. Since the Net is where most programmers spend idle hours, growing numbers of recruiters are using it to chase them down. That's where Michael L. McNeal casts his global net. McNeal, human-resources chief at Cisco Systems Inc., needs to hire 1,000 people each quarter, many of them programmers. Like other recruiters, he buys ads on popular Web sites like the Dilbert page, which funnels



traffic to Cisco's Web site. There, the company lists some 500 current job openings. Applicants in foreign countries can hit hot buttons to translate the page into Cantonese, Mandarin, Russian. And, by filling out a short questionnaire, they can create a résumé and zap it to Cisco.

Cisco's Web page draws 500,000 job searches per month. This gives Cisco gobs of data about the job market, including which companies have interested employees. Armed with the best prospects, McNeal then turns to Cisco employees for help, asking them to call recruits, who speak the same language.

Like the others, Microsoft recruits on the Web and snaps up startups for talent—some 20 companies in 1996, alone. But to get its software up and running throughout the world, Microsoft relies on service companies, which are grossly understaffed. Microsoft calculates that its service partners are

OUTREACH: Microsoft trains potential recruits in Ireland

short 41,000 professionals trained to install Microsoft products. They're forcing the companies to educate new recruits. With an effort known as Skills 2000, Microsoft is pushing into 350 colleges and colleges around the world. It hammers curricula that will produce more programmers, such as adding on-the-job training in business schools.

A big part of the effort is in Europe,

the major market that has 18 million unemployed workers. Microsoft's solution is to invite jobless Europeans in 11 countries into free training programs. In the year, 3,000 Europeans have gone through the program, with 98% finding jobs.

It's in this \$170 billion market for global software services, including Big Six consulting firms, IBM Global Services, Manpower, and many others, that demand for programmers is especially hot. This is because corporations are loaded with help to link far-flung operations with the latest in E-mail networks, inventory control, and finance packages. "The productive sector of the economy is becoming absolutely dependent on software systems," says reengineering author Michael Hammer. "If software disappeared, you couldn't buy a can of soda." **SPECIALTIES.** In the finance capital of London, Tokyo and Hong Kong, companies are installing vast new systems to

to Europe's single currency. Japan's financial deregulation, while, they're working over time to sort out the Year 2000 glitch, dating problem companies when the year of double zeros is around. Mastech Corp., a Pittsburgh-based outsourcer, is sending a handful of programmers a year to follow a Citibank contract in Singapore to London (page 10). Once in London, they'll find the wealth of other business analysts and importing more programmers from South Africa, Sri Lanka, and Australia. "We have 500 now, and we'd hire another 500 if we could find them," says company manager Guil Hastings.

As recruiters travel, they're on regional specialties. The

SOFTWARE SOURCES

U.S. Talented workforce of 2 million. But colleges are not meeting demand.

RUSSIA Potentially 1.6 million programmers, but many of them are unacquainted with new technologies or business.

INDIA 250,000 and growing 10% to 15% a year. With a small domestic software industry, much of the workforce is available for outsourcing work.

JAPAN 1 million, but many of them tied up with proprietary corporate programs, which will be a nightmare to debug by the year 2000.

DATA: BW, STANFORD UNIVERSITY

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sians are whizzes at math. India's university at Puna has a strong Japanese language program, which positions it well for Japan's Year 2000 workload. South African programmers learned to cope during the years of the anti-apartheid boycott with a motley collection of jerry-rigged mainframes. This makes them especially adept at Year 2000 work, which is target-

ed toward aging mainframe software.

As for programmers, the world is their oyster. In a computer lab in Austin, Tex., Natalia Bogataya and her husband, Konstantin Bobovich, both Belorussians and products of Van Derven's so-called Russian connection, labor away on a mainframe program. They've left their college-age children with relatives in Minsk and are debugging insurance

software for Computer Sciences. "We can't use our experience in this country," Bobovich explains, "as my wife said, 'Let's see America.'"

Why not? In today's fervid market, programmers can write their own tickets.

*By Stephen Baker, with
McWilliams in Austin, Texas
Manjeet Kripalani in Bombay*

STALKING THIRD-WORLD SOFTWARE WIZARDS

In her suburban Pittsburgh office, Sushma Rajagopalan, a transplanted Bombay native, surfs the Internet, looking not only for programmers but also for signs of distress, perhaps a currency collapse, or hostage event—something that will spur a software developer to forsake home for the suitcase-lugging life as a programmer for hire. Rajagopalan is a global recruiter for Mastech Corp., a Pittsburgh-based outfit that supplies desperately needed software skills to such giants as Ford Motor Co., IBM, and the U.S. government.

And she knows where to look. Chile, for instance, is one of South America's hot spots for software. But for Rajagopalan, who worked in Citibank's information-technology division in India before moving to the U.S. six years ago, it's simply too prosperous and comfy—there's not enough of what she calls "push" for programmers to pick up and leave. Conversely, she sees promise in strife-torn Colombia, and Hong Kong could be a recruiting oasis if the Chinese crack down. "It's much easier to sell something to people who are anxious to leave," she says.

DANCING APPLETS. Sound a bit cold? It's a sign of the frenzied times for outsourcing companies—and for anyone who is in need of software skills. With worldwide computer technology spending expected to reach \$3 trillion during this decade, the demand is sky-high for software wizards who can do everything from tie global networks together to make an Internet applet dance on a World Wide Web page.

That's where Rajagopalan comes in. She's the No. 1 recruiter for Mastech, a \$125 million company founded 10 years ago by two Indian emigrés, Sunil Wadhvani and Ashok Trivedi.



LOOKING FOR ITCHY FEET

Rajagopalan, Mastech's top recruiter, hunts for brainpower in areas people are eager to leave.

While others in the industry pursue programmers mostly for home-market assignments, Mastech figures that the more talent it finds, no matter where, the faster the company will grow. After all, each employee—there are 2,000—is expected to generate \$90,000 in revenue and an operating margin of 12%. In this calculation, demand does not abate. "This isn't like pork bellies or coffee," says CEO Wadhvani.

In this market, Rajagopalan comes up against all kinds of competition. She puts talented programmers on a job, and pretty soon the customer is sidling up and asking where, exactly, in Sri Lanka or South Africa, she found the worker. She doesn't tell.

Today, says Rajagopalan, who spends half her time on the road, clients are sending human resource execs around the globe to find talent for themselves. "I'm competing with my own customers," she complains.

BENDING RULES. Mastech's plan is to hire hundreds of programmers, dispatch them around the world on projects, and link all of them via satellite to large software factories and training centers in India. Already, the company—which went public last year at \$15 and whose shares are now trading at \$23—has operations in Britain, Canada, Singapore, Australia, and Japan, and a factory in India. "Mastech transformed our business," says Curt Smith, controller at Cloister Spring Water Co. in Lancaster, Pa.

Ideally, Rajagopalan would hire programmers who have mastered English, which is high tech's lingua franca, as well as the latest technologies. But in a hot labor market, everyone settles for less. She's bending on English. And often she has to hire the technology expert she can find and then train them to find a fit for their knowledge. Filipinos, for example, are strong on Unisys systems—just what's required for a major contract under way at the U.S. Housing & Urban Development Dept.

The question, of course, is how global recruiters such as Mastech would weather a drop-off in demand. Wadhvani doesn't see one coming. "The growth of computing power in the world is doubling every two years," he says. "Software has to keep up."

If that's true, Sushma Rajagopalan can expect to bump into lots of fellow recruiters as she roams the world in search of brainpower.

By Stephen Baker in Pittsburgh



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OPTICS

A LENS THAT TRICKS THE LIGHT FANTASTIC

LightPath's new ray-bending technology could revolutionize optics and imaging



DANZIGER WITH LENS: 200 investors funded her quest

When Leslie A. Danziger dropped out of the University of Denver to join her boyfriend in Boston in 1973, she had no idea how much the move would change her life. She never completed her degree. Instead, despite an utter lack of scientific training, Danziger devoted 15 years to developing a radically new type of lens—one that can control light in novel, almost magical ways.

It promises major improvements and cost savings in almost anything with a lens, from cameras and medical endoscopes to lasers and fiber-optic communications—and solar power, which is what got Danziger going. John C. Tesar, U.S. optics director for Germany's Karl Storz Endoscopy, says her lens could be a classic case of "disruptive technology"—so innovative it revolutionizes the field.

What disrupted Danziger's life was her conversion to the environmental cause while she was producing a film

on the Alaskan Pipeline for the Corporation for Public Broadcasting. "What I saw in Alaska convinced me something had to be done to make solar energy more affordable," says Danziger. So in 1985, she founded Integrated Solar Technology Corp. to develop a lens that would eliminate the need for motorized mirrors at such places as Solar One. This solar-energy station in California's Mojave Desert cost \$140 million to build in the early 1980s. The motor systems represented a big chunk of that cost because the mirrors must accurately

track the sun's movement and reflect its rays onto a tower where their heat is converted into electricity.

Danziger envisioned a lens that could point straight up, yet still grab sunlight from dawn to dusk. That would take a lens with a so-called gradient index of refraction, meaning the degree to which it bends light would vary gradually from its periphery to its center. Then, regardless of the angle at which light entered the lens, the light would always come out at the same focus point.

To pull it off, Danziger tapped 200 investors, including friends and relatives, for \$10 million to fund more than a decade of research, until her Albuquerque company, renamed LightPath Technologies Inc., went public early last year. She used the private money to hire some top scientific talent, including Richard Blankenbecler, a theoretical physicist at Stanford University whose weekend avocation is optics.

The notion of gradient-index lenses is hardly new. Every fax and copy machine uses an array of tiny gradient, or "grin," lenses to focus documents. Japan's Nippon Sheet Glass dominates the \$100 million grin-lens market, says Duncan T. Moore, the president of Rochester's engineering department at Gradient Lens Corp.

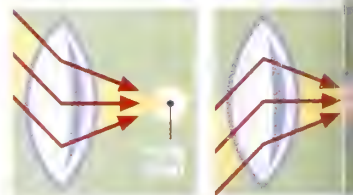
"COMPLETE FLUKE." However, most lenses are only a few millimeters in diameter and rarely exceed 10 millimeters—less than half an inch. Once up in making larger ones occur various glass formulations, each with a different refractive index, are fused by heating them. Each also has a different rate of thermal contraction, which causes internal stresses as newly formed lenses cool. In big lenses, stresses build up and produce optical defects.

In her blissful ignorance, Danziger didn't know this. Just as well, since her search team produced its first large lens in 1990 by melting a stack of different glass formulations. "Only later we find out that what we were doing shouldn't have worked," she says. Storz's Tesar agrees, terming the process through "a complete fluke." Danziger won't reveal precisely how it's done.

From lab curiosity to mass production took five more years. Now, LightPath routinely turns out lenses measuring up to 95 mm across. That's more than enough for camera lenses, and Photo Film Co. has licensed the technology.

ALWAYS FOCUSED

Gradient lenses keep the same focus point by "correcting" light that comes in from different angles.

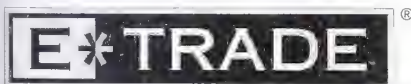


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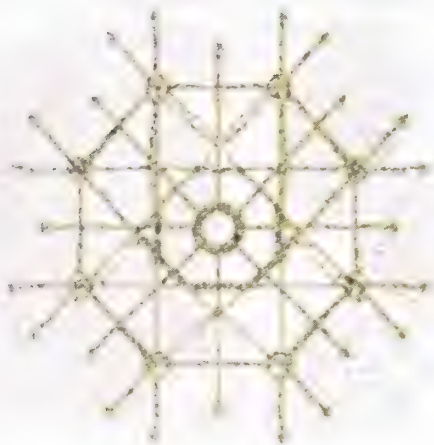
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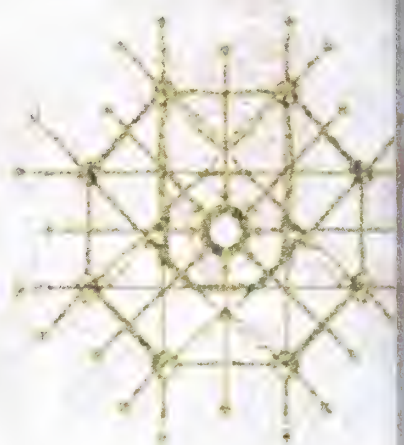
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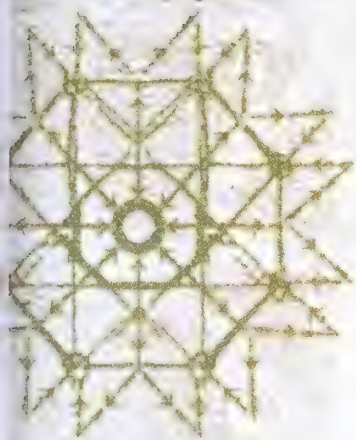
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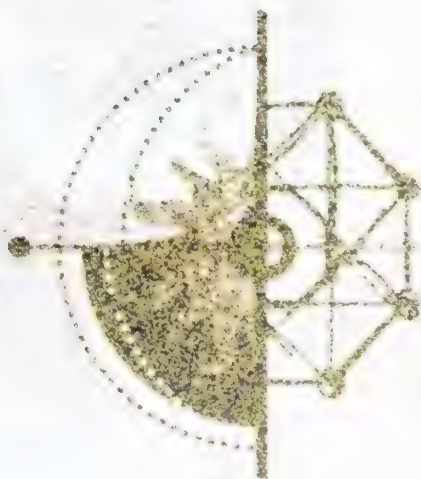
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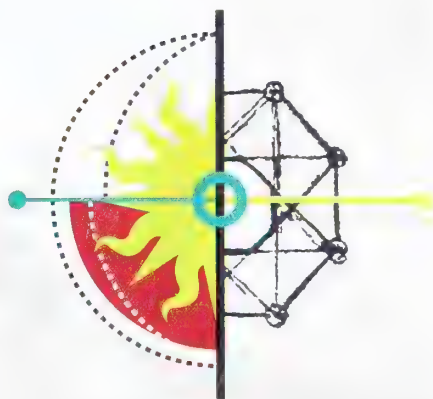
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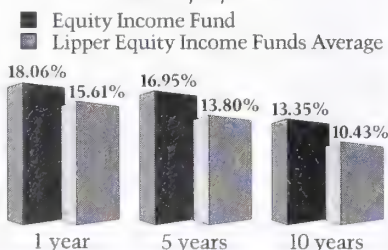
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nology. Danziger figures Fuji cut its raw-material lens costs. The bending power of one of her s Gradium lenses can replace two tional ones in cameras, which t have four or more ground-glass e

LightPath has also spent th developing new lens-design so working with Invention Machin in Cambridge, Mass. Rochester's knows how crucial this is. "Learn design a gradient lens that can uafactured takes at least six mon notes. "Not many people are will after 15 years trying to persuade to do so, Moore decided to get Ca Lens into manufacturing. Its mai uct: borescopes with 4-mm len inspecting the inside of rifle lar They sell for \$350 to \$550—roug of the cost of conventional bore Both Gradient Lens and LightP working on similar products, cas doscopes, for the medical marke **TELECOM BILLIONS.** The fattest may come from telecommunication. Internet's growth is prodding th phone companies to boost capacity. AT&T, MCI Communications, and are turning to a technology calleo length-division multiplexing. W multiplies the capacity of fiber-opt systems by splitting laser light in eight, or more streams of separate ors, each carrying as much data original signal. The phone com expect to spend billions on WDM.

To get in on this action, Light and Invention Machine in July from joint venture, LightChip Inc., s duce WDM systems that can han 32 colors now, with 100 colorsn offing. "Our main focus will be c area networks," says Joel C. Golt LightPath's marketing vice-prac That's just for starters. Ray T. C electrical engineer at the Univ Texas in Austin and a LightPa sultant, says Gradium has beni long-haul systems as well. It ca more sharply on an optical fibe As a result, splicing two fibers er—which is done every few m the signals can be amplified—v require brain-surgery precision.

Danziger hasn't given up her ex mentalism. LightPath has a contr San Diego's D-R Technologies Inc develop a "light pipe" to channel t rays to solar cells that power th satellites. She also aims for privat spin-offs, since "I still believe sol er will be a major energy sour probably not for 10 years." Mea she'll settle for the other type of

By Otis Port in Ne

BY NEIL GROSS

EARLY TEST FOR LARGEST TUMORS

CANCER IS MOST likely when caught early. But mammography has a limited ability to detect very small tumors. A team at the Weizmann Institute of Science, led by chemistry professor Hadassah Deshpande, has developed an early test that can detect tiny lesions, distinguishing which ones are benign from which ones are malignant. The test involves injecting a patient with a contrast agent that gets taken up by the tumor. The agent is then imaged by a technique called dynamic contrast-enhanced MRI. The procedure uses an imaging period of only a few seconds, compared to the four minutes typically used for a standard MRI. The contrast agent is injected three times—once before the dye is injected and twice after. That allows doctors to see how quickly the contrast agent enters the tumor, how long it stays there, and how it is cleared away. Differences in speed are reported by different colors on the screen, which displays telltale signs of malignant cancer, such as the abundance of leaky blood vessels around the tumor.

concern: The procedure is more expensive than a standard MRI. So it is only initially being used on young women who have a genetic predisposition to cancer. Deshpande is seeking funding for more clinical trials.

Naomi Freundlich

RIDING THE RAILS WITH A NOSE FOR ADVENTURE

IMAGINE BOARDING A TRAIN and, while riding the rails, escaping to an undersea world off the coast of Jamaica. You hear the sound of crashing waves and smell the scents of salt water and suntan oil. For a small fee—still to be determined—passengers will be able to do just that on First American Railways Inc.'s new Florida Fun train, which will begin running from Orlando to Fort Lauderdale in October.

Seated at virtual reality kiosks called Virtual Scentsations, users will wear hel-



metts developed by Digital Tech Frontier, a high-tech entertainment company in Phoenix. In addition to synthetic sights and sounds, the gear will deliver a range of familiar odors. These are created with liquid chemicals from foodstuffs, which are converted into a gas and released into the helmet in

sbursts every three milliseconds. Scott Jochim, founder of Digital Tech Frontier, admits that scents from unrelated sources can seem similar—and therefore be confusing. But visual and aural cues will help kiosk users interpret them in context.

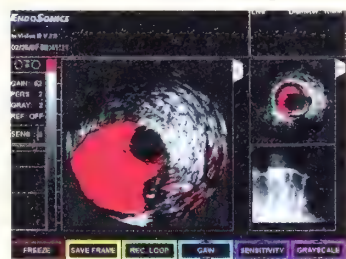
So far, Digital Tech Frontier has generated three different scenarios, including a tour of Egypt's pyramids, in which the traveler will smell fiery torches. But the company believes entertainment kiosks are just the beginning. Since scent can trigger emotional responses, Digital Tech Frontier sees therapeutic uses for VR technology, such as helping chemotherapy patients relax before and after treatment. *Elizabeth Veomett*

A CLOSE-UP OF ARTERY TROUBLE

FOR SEVERAL YEARS, DOCTORS HAVE USED ULTRASOUND to obtain close-up views of plaque on coronary artery walls. The technique, called intravascular ultrasound (IVUS), is performed by means of a catheter inserted into the artery. It provides detailed information on the location and type of plaque—a big step up from older angiography that relies on iodine dyes and X-rays to create 2-D pictures.

Now, EndoSonics Corp. of Rancho Cordova, Calif., is improving the versatility of catheter-based ultrasound. Its EndoSonics Five-64 catheter uses feedback from 64 sensor elements, rather than one moving aperture. This eliminates the need for moving parts. EndoSonics' system provides both an ultrasound image and additional analysis on blood flow, says Dr. Steven R. Bailey of the University of Texas Health Sciences Center at San Antonio. What's more, the new technology allows doctors to perform balloon angioplasty and ultrasound simultaneously, saving procedural time and cost.

EndoSonics' approach is especially useful in treating patients with coronary artery blockage. For example, doctors have used it to determine the optimal diameter for implanted stents used to hold open the artery wall. And, EndoSonics says, patients treated with IVUS-guided therapy generally experience fewer complications than those treated without IVUS. *Elizabeth Veomett*



INNOVATIONS

■ Here's a new twist on virtual manufacturing: The National Institute of Standards & Technology (NIST) plans to develop computer models of machine tools, which will help determine the viability of new product designs. Today, designs are regularly revamped because of machine-tool limitations. Transplanting this process from the real world to a digital one, NIST figures, could greatly reduce the time it takes to get new products to market.

■ High-energy physicists have a fresh take on low-energy appliances. Working with the Association of Home Appliance Manufacturers, Oak Ridge National Laboratory has developed a refrigerator that uses only half as much energy as today's models. Thanks to such changes as better insulation and the replacement of AC with DC motors, researchers trimmed the 20 cubic-foot fridge's thirst for power to levels that are actually below the ones mandated by an Energy Dept. rule announced on Apr. 24.

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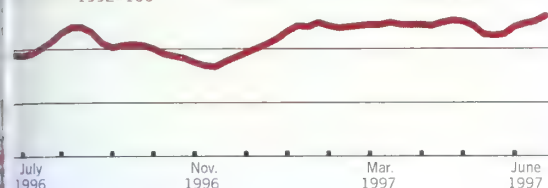
Business Week Index

PRODUCTION INDEX

Change from last week: 0.4%
Change from last year: 2.9%

PRODUCTION INDEX

June 28=123.0
1992=100



The production index increased again during the week ended June 28. Before the four-week moving average, the index also increased, to 122.7. Seasonally adjusted output of coal and lumber were very strong, offsetting declines in steel, crude-oil refining, and automobiles. For the month of June, the index advanced to 123.0, from a low of 121.3 in May.

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PRICES

	LATEST WEEK	WEEK AGO	YEARLY % CHG
PRICES (7/3) S&P 500	916.92	887.30	39.5
GOVERNMENT BOND YIELD, Aaa (7/4)	7.35%	7.36%	-3.5
RAW MATERIALS PRICES (7/4)	105.9	106.2	0.1
STOCK FAILURES (6/27)	NA	NA	NA
GOVERNMENT LOANS (6/25) billions	NA	NA	NA
SUPPLY, M2 (6/23) billions	\$3,918.4	\$3,911.3r	4.7
CLAIMS, UNEMPLOYMENT (6/28) thous	337	332	-4.0

Standard & Poor's, Moody's, Journal of Commerce (index: 1990=100), Reserve, Labor Dept.

INTEREST RATES

	LATEST WEEK	WEEK AGO	YEAR AGO
GOVERNMENT FUNDS (7/8)	5.46%	6.24%	5.14%
GOVERNMENT BOND, 3-month (7/9)	5.58	5.64	5.54
RATES OF DEPOSIT (7/9) 3-month	5.60	5.67	5.55
MORTGAGE (7/3) 30-year	7.83	7.81	8.36
ADJUSTABLE MORTGAGE (7/3) one-year	5.85	5.88	6.07
(7/4)	8.50	8.50	8.25

Federal Reserve, HSH Associates, Bloomberg Financial Markets

a in the production indicators are seasonally adjusted in computing the BW index (chart); other components (estimated and not listed) include machinery and defense. 1=Western Wood Products Assn. 2=Southern Forest Products Assn. 3=Free market value NA=Not available r=revised NM=Not meaningful

THE WEEK AHEAD

SALES

July 15, 8:30 a.m. EDT ► Retail sales probably rose 0.2% in June, according to the median forecast of economists surveyed by MMS International, one of The Hill Companies. Excluding cars, sales were up a stronger 0.4%. Store sales have been falling since March. In June, they fell 0.1% for all items, whether motor vehicles are excluded.

CONSUMER PRICE INDEX

July 16, 8:30 a.m. EDT ► The MMS forecast expects a small 0.2% increase for consumer prices of all goods and services as well as for core prices, which exclude food and energy. In May, the

overall CPI rose 0.1%, while the core index edged up 0.2%.

BUSINESS INVENTORIES

Wednesday, July 16, 8:30 a.m. EDT ► Inventories held by manufacturers, wholesalers, and retailers grew 0.3% in May, the same increase recorded in April. Factories have already reported a 0.4% gain in their stockpiles.

INDUSTRIAL PRODUCTION

Wednesday, July 16, 9:15 a.m. EDT ► The MMS forecast expects that industrial output rose 0.3% in June, after a 0.4% advance in May. However, the gain may be less since total hours worked in manufacturing fell.

The average operating rate for all industry in June likely remained at May's 83.7%.

HOUSING STARTS

Thursday, July 17, 8:30 a.m. EDT ► Housing starts probably rebounded to an annual rate of 1.41 million in June. Starts had fallen for three consecutive months, including a 4.8% drop in May.

INTERNATIONAL TRADE

Friday, July 18, 8:30 a.m. EDT ► The foreign trade deficit for goods and services likely widened to \$9 billion in May, from \$8.4 billion in April. Exports, which have risen for three months in a row, likely fell, while imports continued to rise to record highs.

PRODUCTION INDICATORS

	LATEST WEEK	WEEK AGO	YEARLY % CHG
STEEL (7/5) thous. of net tons	2,080	2,043#	4.1
AUTOS (7/5) units	1,491	1,154#4r#	-37.1
TRUCKS (7/5) units	14,678	120,402r#	39.5
ELECTRIC POWER (7/5) millions of kilowatt-hrs.	69,519	72,792#	0.0
CRUDE-OIL REFINING (7/5) thous. of bbl./day	14,762	14,988#	4.3
COAL (6/28) thous. of net tons	20,412#	19,448	9.6
LUMBER (6/28) millions of ft.	508.5#	485.7	7.3
RAIL FREIGHT (6/28) billions of ton-miles	26.5#	26.1	3.5

Sources: American Iron & Steel Institute, Ward's Automotive Reports, Edison Electric Institute, American Petroleum Institute, Energy Dept., WWPAl, SFPAl, Association of American Railroads

PRICES

	LATEST WEEK	WEEK AGO	YEARLY % CHG
GOLD (7/9) \$/troy oz.	317.300	332.200	-17.2
STEEL SCRAP (7/8) #1 heavy, \$/ton	138.50	138.50	3.7
COPPER (7/4) ¢/lb.	116.6	116.7	26.1
ALUMINUM (7/4) ¢/lb.	76.0	75.3	9.4
COTTON (7/5) strict low middling 1-1/16 in., ¢/lb.	72.10	72.19	-5.7
OIL (7/8) \$/bbl.	19.34	19.83	-9.2
CRB FOODSTUFFS (7/8) 1967=100	235.45	237.49	-15.9
CRB RAW INDUSTRIALS (7/8) 1967=100	332.51	335.36	-0.1

Sources: London Wednesday final setting, Chicago market, Metals Week, Memphis market, NYMEX, Commodity Research Bureau

FOREIGN EXCHANGE

	LATEST WEEK	WEEK AGO	YEAR AGO
JAPANESE YEN (7/9)	112.82	114.41	110.08
GERMAN MARK (7/9)	1.76	1.75	1.52
BRITISH POUND (7/9)	1.69	1.67	1.55
FRENCH FRANC (7/9)	5.95	5.91	5.16
ITALIAN LIRA (7/9)	1717.8	1705.8	1534.3
CANADIAN DOLLAR (7/9)	1.37	1.38	1.37
MEXICAN PESO (7/9)	7.885	7.947	7.611
TRADE-WEIGHTED DOLLAR INDEX (7/9)	103.2	103.7	98.3

Sources: Major New York banks. Currencies expressed in units per U.S. dollar, except for British pound in dollars. Trade-weighted dollar via J.P. Morgan

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Index to Companies

This index gives the starting page for a story or feature with a significant reference to a company. Most subsidiaries are indexed under their own names. Companies listed only in tables are not included.

A

Abbott Laboratories (ABT) 84
Access Research 58
Advil (AHP) 6
Aeroflot 110
Ajinomoto 42
Alamo Rent-A-Car 58
Alliance Capital 6
Alpha Group 62
Alternative Technology Resources 110
Amazon.com 40
American Airlines (AMR) 52
American Express (AXP) 58, 70, 84, 102
America Online (AOL) 36, 40
Amentech (AIT) 33
AMG Data 104
AMR Combs 52
Andersen Consulting 110
Apple Computer (AAPL) 32
AT&T (T) 33, 118
Atlas 8
Automatic Data Processing (AUD) 36
AutoPacific 98

B

Bankers Trust (BT) 102
Barrick Gold (ABX) 104
Bath Iron Works (GD) 108
Bear Stearns (BSC) 6
Bell Atlantic (BEL) 33
Bloomberg Financial Markets 36
Boeing (BA) 28, 70, 130
Bombardier (BBB.B) 52
Bridge Information Services 36
British Airways (BAB) 40, 48
Broadview Associates 36
Broderbund Software (BROD) 18
Brooks Fiber Properties (BFPT) 33
Brown Brothers Harriman 40
Business JetSolutions 52

C

Calvin Klein 12
Capital Market Risk Advisors 102
Cessna (TXT) 52
Chase Manhattan (CMB) 40, 102
Chase Securities (CMB) 35
Chiron (CHIR) 108
CIGNA 58
Cisco Systems (CSCO) 110
Citibank (CCI) 36, 102, 106, 110, 116
Citizen Watch 42
Coca-Cola (KO) 38
CompuServe (CSRV) 36
Computer Sciences (CSC) 110
Continental Airlines (CAI.A) 85
Control Data Systems 36
Corel 18
Corning (GLW) 93
Creative Artists Agency 15

D

Dai-ichi Kangyo Bank 42
Dairy Queen (INDQ) 6

Dataquest 32

Detroit Diesel (DDC) 40
Dewey Ballantine 28
Diametrcs Medical (DMED) 108
Digital Tech Frontier 123
Donaldson Lufkin & Jenrette (DLJ) 6
Dow Jones (DJ) 36
DRI/McGraw-Hill (MHP) 22
D-R Technologies 118
Duracell (DUR) 38

E

East Rand Proprietary Mines 104
EJV 36
Electronic Data Systems (EDS) 110
EndoSonics 123
Equitable (EQ) 40
Ernst & Young 110
Evensky Brown Katz & Levitt 62
Evergreen Woods 70
Excite 40
Executive Jet Aviation 52

F

Fairfield Financial Advisers 62, 78
Fidelity Investments 62
First American Railways 123
Ford (F) 14, 70, 98, 116
Foxwoods Resort Casino 38
Frito Lay (PEP) 85
Fuji Photo Film (FUJII) 118

G

General Dynamics (GD) 108
General Electric (GE) 15
Genesis Merchant Group (GMGS) 108
Goldman Sachs 52, 102
Goldstein Golub Kessler 70
Gradient Lens 118
Grupo Modelo 49
Gulfstream Aerospace (GAC) 52

H

H&R Block (HRB) 36
Headway Corporate Resources (HDWY) 108
Hilton Hotels (HLT) 8, 38
Hirschfeld Stern Moyer & Ross 58
Honda (HMC) 98
Hongkong & Shanghai Banking 12
HSBC Washington Analysis 22
Hyatt 8

I

IAI Mutual Funds 108
IBC Financial Data 6
IBM (IBM) 32, 58, 110, 116
Indian River Colony Club 70
International Paper (IP) 40, 85
Invention Machine 118
ITT-Sheraton (ITT) 8

J

Jaguar (F) 98
John Hancock 58
JSA Research 28

K

Karl Storz Endoscopy 118
Kirin Brewery 42
Knight-Ridder (KRI) 36

L

Lehman Brothers (LEH) 108
Lexington Goldfund 104
LightChip 118
LightPath Technologies (LPTHA) 118
Litton Industries (LIT) 28, 108
Lockheed Martin (LMT) 28, 70, 108, 130
Loral 28
Lord & Taylor 85
Lowe's 58

M

Manpower (MAN) 110, 116
MarketVision 36
Mastech (MAST) 110, 116
Matsushita 15
May Department Stores (MAY) 85
Mazda 98
McDonald's (MCD) 12, 38, 40
McDonnell Douglas (MD) 28
McGraw-Hill (MHP) 127
MCI Communications (MCIC) 38, 118
Merrill Lynch (MER) 58, 88, 102, 108
MFS Funds 58
Microsoft (MSFT) 36, 88, 110
MMS International (MHP) 127
Mohegan Sun 38
Moody's Investors Service (DNB) 38
Morgan (J.P.) (JPM) 102
Morgan Stanley Dean Witter 49, 98
Mori Sogo 42
Morningstar 104
Morrison Brown Argiz 62

N

National Center for Retirement Benefits 85
NatWest Securities (NW) 40
Netscape Communications (NSCP) 110
Newmont Mining (NEM) 104
Nextrend 98
NeXT Software 32
Nike (NKE) 12
Nintendo 12
Nippon Sheet Glass 118
Nissan 98
Nomura Securities 42
Northrop Grumman (NOC) 28, 130
Nymex (NYN) 33

O

Oppenheimer 104
Oracle (ORCL) 110
Outboard Marine (OM) 40
Owens Corning (OWC) 110

P

Panasonic 18
Pension Benefit Guaranty 85
PepsiCo (PEP) 12, 38
Pequot Tower 38
Power Computing 32
Power (J.D.) 98
Price Waterhouse 88
Procter & Gamble (PG) 62, 102
Public Agenda 76

Q

Quick & Reilly (BQR) 62

R

Raritan Computer 18
Raytheon (RTN) 28, 58
Regional Financial Associates 22, 35
Reuters 36
Revlon (REV) 8
Rhine-Poulenc Rorer
R.J. Reynolds Tobacco
Rockwell International (ROK) 130
Rondan Doyukai 42
Roux Associates 76
Royal LePage 110

S

Sammee's Cleaning S
SAP 110
SBC Communications
Schwab (Charles) (SC
Security General Fin
Management 78
Shell Oil (RD) 52
Shenkman Capital
Management 102
Sherburne Powers &
Needham 78
SoGen Gold Fund 10
Solon Short Duration
Bond Fund 62
Sony (SNE) 15, 40, 4
Sprint (FON) 118
Stralem 104
Sun Microsystems (SUN)

T

Talbots (TLB) 40
Teledyne 108
Teleport Communicat
Group 33
Texas Instruments (T
Times Mirror (TMC) 8
Toyota (TOYOT) 14, 5
Travelers (TRV) 58
T. Rowe Price 62, 76
TWA (TWA) 57

U

Unisys (UIS) 116
Universal Studios 40
UNUM (UNM) 58
U.S. Global Investors 14
UUNET (UJNT) 40

V

Valujet (VJET) 57
Vanguard Group 88
Visa 36

W

Walt Disney (DIS) 15
Waterford Hotel Group
Waterhouse Securities
Waters Information S
Wechsler Hanwood H
Feffer 6
Weiner Edrich Brown
Wells Fargo (WFC) 4
Welsh Carson Anders
Stowe 36
Westinghouse (WX)
Weston Capital
Management 108
Wrangler (WFC) 6

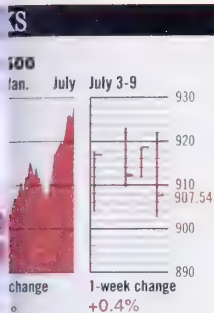
X

Xerox (XRX) 38

Y

Yahoo! (YHOO) 40

Investment Figures of the Week



MARKET
up week for stocks, despite sharp 119-point sell-off in Dow industrials on July 9. The equity market reacted favorably to the rally in the rate on long Treasuries at a five-month low. But it was very much called the individual stocks. Wells Fargo fell 18% to 260 on July 9 news that second-quarter earnings would not meet expectations. Motorola, on the other hand, surged 3 1/2% to 85 1/2% on earnings-exceeded profits. The Dow Jones jumped on the results. So far this year, it has gained 43%.

U.S. MARKETS	Latest	% change Week	% change Year
Dow Jones Industrials	7842.4	0.6	40.0
NASDAQ Combined Composite	1486.6	2.1	28.9
S&P MidCap 400	294.6	1.0	27.5
S&P SmallCap 600	163.3	0.8	24.7
S&P SuperComposite 1500	193.9	0.5	36.8

SECTORS	Latest	% change Week	% change Year
Bloomberg Information Age	278.3	3.0	39.5
S&P Financials	103.1	-0.7	58.4
S&P Utilities	200.1	-0.3	3.6
PSE Technology	301.8	4.2	50.5

FOREIGN MARKETS	Latest	% change Week	% change Year
London (FT-SE 100)	4762.4	0.2	26.5
Frankfurt (DAX)	4055.9	5.2	58.0
Tokyo (NIKKEI 225)	19,697.2	-2.5	-9.6
Hong Kong (Hang Seng)	14,703.7	-3.2	34.5
Toronto (TSE 300)	6574.6	0.4	29.5
Mexico City (IPC)	4836.5	6.1	56.7

FUNDAMENTALS	Latest	Week ago	Year ago
S&P 500 Dividend Yield	1.63%	1.82%	2.19%
S&P 500 P/E Ratio (Last 12 mos.)	23.3	22.6	18.9
S&P 500 P/E Ratio (Next 12 mos.)*	18.6	17.8	NA
First Call Earnings Surprise*	4.01%	4.25%	NA

TECHNICAL INDICATORS	Latest	Week ago	Reading
S&P 500 200-day average	778.4	773.9	Positive
Stocks above 200-day average	80.0%	78.0%	Negative
Options: Put/call ratio	0.49	0.52	Negative
Insiders: Vickers Sell/buy ratio	2.02	1.91	Neutral

Data: Bloomberg Financial Markets; *First Call Corp.

BEST-PERFORMING GROUPS	Last month%	Last 12 months%
Trucking	23.9	97.8
Toys	16.2	86.3
Communications Equip.	14.6	82.6
Oil & Gas Drilling	14.3	76.2
Personal Loans	14.2	75.9

WORST-PERFORMING GROUPS	Last month%	Last 12 months%
Gold Mining	-13.1	-31.8
HMOs	-7.4	-10.7
Oil Exploration & Prod.	-6.3	-4.1
Broadcasting	-5.6	-0.7
Photography/Imaging	-4.6	0.8

BLOOMBERG MONEY FLOW ANALYSIS

Rebound ahead? Stocks with most significant buying on price weakness

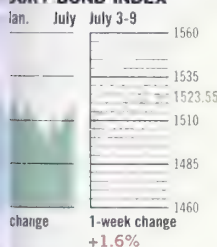
	Price	1-month change
Aetna	105 1/16	-3 1/16
United Healthcare	52 1/2	-3 1/4
Tele-Communications	15 3/4	-5/16
American Home Products	76 1/2	-3/8
Phelps Dodge	84 7/16	-13/16
PacificCare Health Systems	65	-17 3/8

Decline ahead? Stocks with most significant selling on price strength

	Price	1-month change
Intel	149 7/8	3/8
Microsoft	131 1/4	6 1/8
Dell Computer	127 3/4	15 3/4
Philip Morris	44 7/16	1 9/16
Boeing	56 1/8	1/8
Nike	57 1/2	1/2

EST RATES

TREASURY BOND INDEX



Data: Bloomberg Financial Markets

KEY RATES	Latest	Week ago	Year ago
MONEY MARKET FUNDS	5.17	5.17	4.94
90-DAY TREASURY BILLS	5.09	5.18	5.34
6-MONTH BANK CDS	5.19	5.19	5.02
1-YEAR TREASURY BILLS	5.50	5.64	5.95
10-YEAR TREASURY NOTES	6.25	6.45	7.00
30-YEAR TREASURY BONDS	6.56	6.74	7.15
LONG-TERM AA INDUSTRIALS	7.02	7.22	7.65
LONG-TERM BBB INDUSTRIALS	7.40	7.61	8.07
LONG-TERM AA TELEPHONES	7.31	7.47	7.96

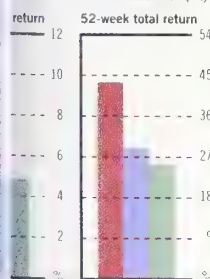
BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 31% federal tax rate.

	10-yr. bond Latest week	Last week	30-yr. bond Latest week	Last week
GENERAL OBLIGATIONS	4.68%	4.77%	5.25%	5.34%
PERCENT OF TREASURIES	74.93	74.49	80.04	79.62
TAXABLE EQUIVALENT	6.78	6.91	7.61	7.74
INSURED REVENUE BONDS	4.78	4.88	5.43	5.53
PERCENT OF TREASURIES	76.54	76.24	82.78	82.45
TAXABLE EQUIVALENT	6.93	7.07	7.87	8.01

AL FUNDS

* U.S. Diversified ** All Equity



Data: Morningstar, Inc.

EQUITY FUNDS

Leaders	Four-week total return	%	Laggards	Four-week total return	%
American Heritage	20.7		Bull & Bear Gold Investors	-22.6	
Wright Equifd.-Mexico	16.9		Gabelli Gold	-22.5	
Lexington Troika Russia	15.6		Morgan Stan. Inst. Gold A	-21.7	
Amerindo Technology D	14.8		Midas	-21.6	
Diversified Aggr. Equity	14.0		Van Eck Gold Opport. A	-21.5	
Leaders	52-week total return	%	Laggards	52-week total return	%
Lexington Troika Russia	86.2		Frontier Equity	-55.5	
Morgan Stan. Inst. Lat. Am. A	68.1		United Svcs. Gold Shares	-51.1	
Morgan Stan. Latin Amer. A	66.0		Bull & Bear Gold Investors	-45.2	
Fidelity Select Electronics	65.4		Morgan Stan. Inst. Gold A	-44.0	
Legg Mason Value Primary	64.3		Lexington Strategic Invmts.	-42.0	

EQUITY FUND CATEGORIES

Leaders	Four-week total return	%	Laggards	Four-week total return	%
Latin America	11.9		Precious Metals	-16.3	
Technology	8.2		Japan	-0.9	
Diversified Emerging Mkts.	7.2		Diversified Pacific/Asia	0.5	
Communications	7.2		Natural Resources	1.0	
Large-cap Growth	7.2		Unaligned	2.6	
Leaders	52-week total return	%	Laggards	52-week total return	%
Financial	52.3		Precious Metals	-31.9	
Latin America	48.5		Japan	-4.8	
Large-cap Blend	36.8		Diversified Pacific/Asia	5.3	
Large-cap Value	35.8		Pacific/Asia ex-Japan	9.1	
Large-cap Growth	35.0		Small-cap Growth	9.4	

as of market close Wednesday, July 9, 1997, unless otherwise indicated. Industry groups 500 companies only. Fundamentals, technical indicators, Bloomberg money flow analysis,

and mutual fund returns are as of July 8. For a more detailed explanation, write to us or E-mail figures@businessweek.com. NA=Not available **Vanguard Index 500 Fund

DON'T SELL THE NEW ECONOMY SHORT

The "it can't get better than this" economy is beginning to make some people nervous. Call it the backlash to economic optimism or the New Economy be damned, but a growing number of pundits are telling us why seven years of noninflationary growth cannot continue and why the stock market has to crash. Without naming names, we'd like to simply list all the "whys." Here goes:

■ *Naive boomers panic.* The irrational exuberance of aging baby boomers betting their retirements on stocks sends share prices to ridiculous heights. A downturn becomes a rout affecting consumer confidence, spending, and growth. Unused to major market corrections (the last being in 1987), the boomers cause their own recession.

■ *Alan blows it.* Greenspan's run of luck at the Federal Reserve runs out, and he zigs when he should zag. This could go one of two ways. Either he doesn't raise interest rates early enough and inflation resurges, or he raises them too much and a deflationary cycle takes hold killing corporate profits.

■ *Global synch.* Europe and Japan finally take off, and all that excess capacity overseas disappears. Capacity utilization suddenly becomes important again, and prices begin moving higher, setting off an inflationary spiral.

■ *The computer millennium meltdown.* Computer systems fail around the world because most of them aren't programmed to recognize the year 2000. Companies might have to spend up

to \$600 billion over the next two years to solve the problem. Or they run out of money and things go crash in the night all over the world.

■ *Wage hikes kick in at last.* Job insecurity abates, and companies can't hold the line anymore. With unemployment at 4½% to 5%, workers demand their just reward. Wage inflation takes off.

■ *Curveballs.* History shows that stuff happens. Sooner or later, a problem, another appears uninvited. Who predicted the Asian shock, the Japanese bubble, the savings and loan disaster, the euro-induced Euro-slump? Some exogenous variable inevitably knocks the economy off course.

Had enough? Call us Panglossian, but we think global information technology, and deregulation are changing the shape of the business cycle (BW—Mar. 31). It's now possible to have higher noninflationary growth and lower unemployment and nothing on the horizon appears to alter that situation seriously. It doesn't mean the end of the business cycle, surely as the Dow Jones industrial average will have a peak, there will be a recession and a market correction. But it won't change the economic basics. Our advice: Forget the glitches and boomer panic—and don't bet on Greenspan's exit anytime soon. Keep your eye on wages, wait for globalization, and watch out for that totally unexpected thing. Bottom line? The New Economy will roll on.

DEFENSE: THE CIRCLE IS GETTING TIGHT

Is defense consolidation going too far? Lockheed Martin's planned purchase of Northrop Grumman in an \$11.6 billion transaction will leave the industry dominated by three giant corporations—Boeing, Lockheed, and Raytheon. But for many critical products such as fighter jets and electronics, there may now be only two potential prime contractors competing for any one major contract. Worse, the number of independent suppliers will decline sharply. The worry is that this concentration may hurt the kind of innovation and price competition sorely needed in defense.

Even before Defense Secretary William J. Perry invited defense industry executives to dinner in 1993 and suggested they merge, the industry was uniquely defined by an incestuousness unknown in the rest of the economy. The Pentagon deliberately parceled out contracts and encouraged defense companies to share in them in order to maintain a huge military-industrial base against the Soviets. It relied on competition among suppliers to keep prices in check and to foster much of the innovation, especially in electronic warfare, which generates nearly half of all new contracts. With the Lockheed Martin-Northrop Grumman combination, there will now be two companies dominating defense electronics. In 1990, there were 25 defense electronics companies. Now,

only Raytheon Co. will compete with Lockheed on many terms (page 28).

Not only are the prime contractors consolidating but they are also becoming more vertically integrated. A Lockheed Martin-Northrop Grumman will essentially own many of its suppliers. Not only will it make jet-fighter frames but it will also be able to supply the core electronics, radar, and missiles. In the past, many of these would have come from independent companies. The same is true for space operations, bringing many suppliers in-house. Last year, Northrop Grumman bought Westinghouse's defense electronics operation.

One solution is to open the U.S. weapons market to foreign competition. The British, Germans, French, and Soviets make serious weapons. They can't compete in jet fighters against the F-18 or the F-117 Stealth fighter, but they can make quality electronic warfare systems, missile submarines and other weapons. Post-cold war, it makes sense for the West (perhaps eventually even Russia) to have a large, open military arms market. That could promote innovation and price competition, a Lockheed-Boeing-Raytheon troika notwithstanding.

HIGH-PERFORMANCE PRAISE. ALL-THROTTLE ACCOLADES.



"THIS TAURUS SHO IS TERRIFIC. IT IS A FAST CAR, BOTH CONFIDENT AND ATHLETIC. IT IS ALSO A REFINED CAR, BOTH QUIET AND COMPOSED. AND IT SURE DOESN'T COST MUCH, DOES IT?"

Automobile Magazine
(July 1996)

"SHO'S 3.4-LITER 4-CAM V-8, A MARVEL OF COMPACTNESS AND SMOOTHNESS, MAKES 235 BHP WITH LITTLE STRAIN."

Road & Track
(July 1996)

"THE 235-HP V-8 ENGINE HAS A HEALTHY SNARL, AND ITS POWER IS CONCENTRATED WHERE IT'S NEEDED."

"REFINEMENT AND SPORTINESS AT A FAIR PRICE."

Car and Driver
(July 1996)

"BACK-ROAD PASSING IS NEVER A CONCERN, AND ESCAPING THE TRUCK RACES ON THE INTERSTATE TAKES JUST A TOUCH OF THE TOE."

AutoWeek
(April 29, 1996)

"YOU GET THE FUN OF A HIGH-PERFORMANCE SPORTS MACHINE, WITHOUT SACRIFICING ROOM FOR THE KIDS."

USA TODAY
(June 19, 1996)

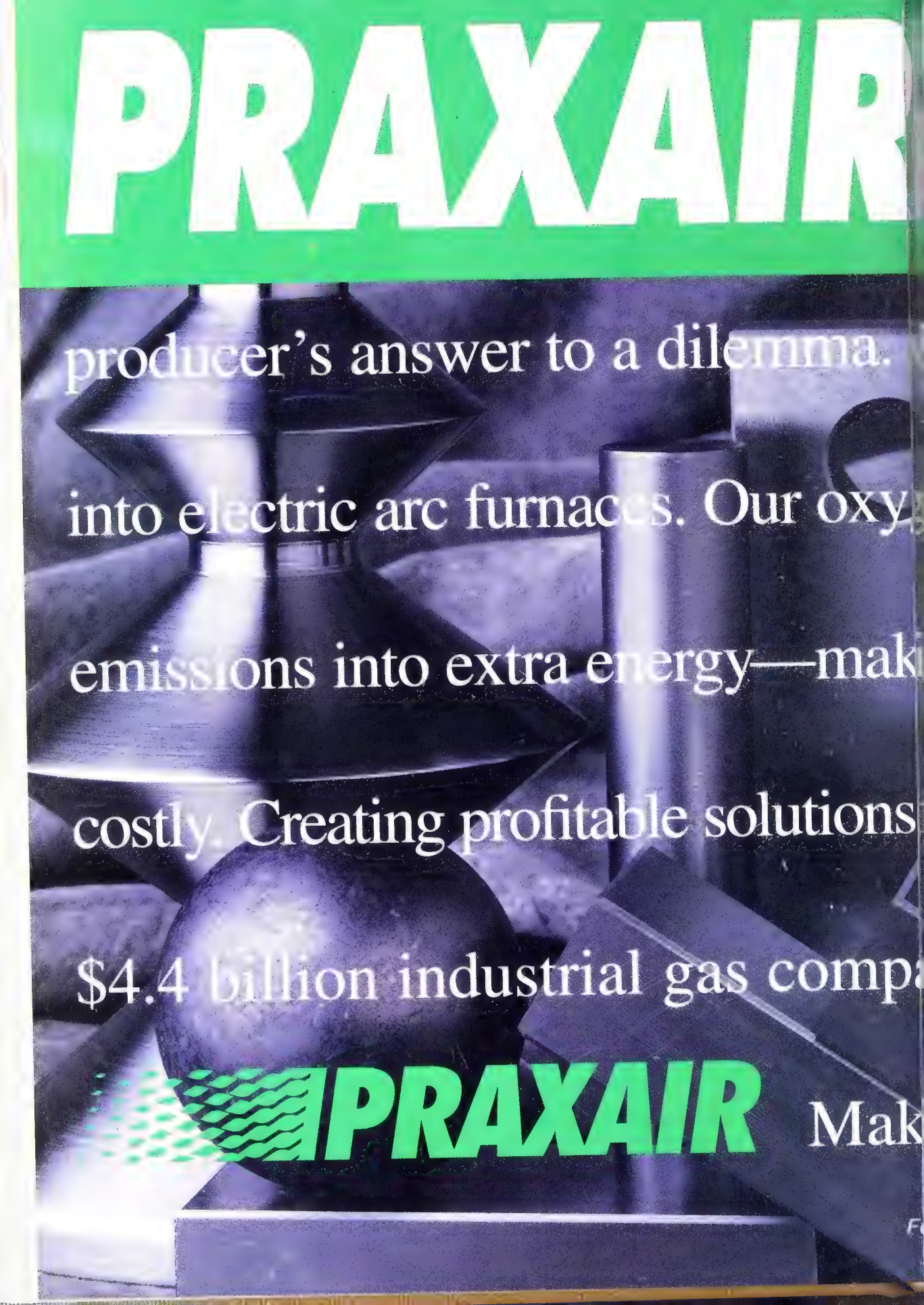
FORD TAURUS SHO

HAVE YOU DRIVEN A FORD LATELY?



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into electric arc furnaces. Our oxy

emissions into extra energy—mak

costly. Creating profitable solutions

\$4.4 billion industrial gas compa

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BusinessWeek

8, 1997

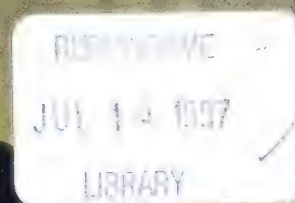
A PUBLICATION OF THE MCGRAW-HILL COMPANIES

\$3.50

GIANNI VERSACE

created one of
the world's great
fashion companies.
Can it survive
without him?

DEATH OF A FASHION MOGUL



EXCLUSIVE:
A Recent Interview

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Internet: www.businessweek.com America Online: Keyword: BW

At Rolex,

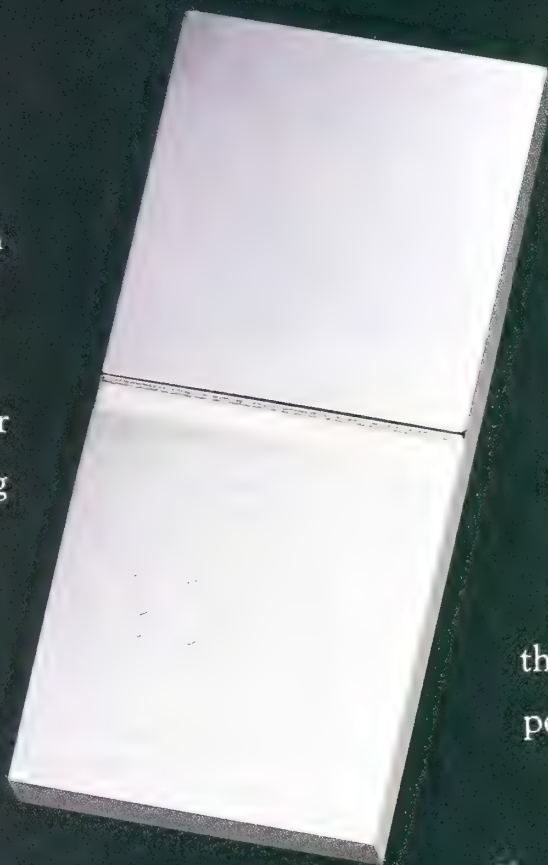


Rolex Oyster Perpetual Air-King in stainless steel with matching Oyster bracelet

steel is a precious metal.

Impurities in steel can not only compromise its toughness and durability but can mar the effects of polishing by leaving little telltale traces called "comet trails."

To eliminate this,



the Oyster case of this \$2,250 Air-King is made of steel classified as "904 L," the finest quality used in watchmaking and, perhaps, now that we think of it, why so many people take a shine to it.



ROLEX

COVER STORY

AFTER VERSACE

The business drive of the Versace clan is legendary. But can the fashion empire survive the slaying of its creative soul?

page 76



BusinessWeek

JULY 28, 1997

Cover Story

76 AFTER VERSACE

Before his murder on July 15, Gianni Versace was planning to transform his family-run fashion house into a global, professionally run brand wrapped in a publicly traded company. The IPO was shaping up as one of Europe's hottest stock offerings of 1998. Can the hopes and dreams he and his family nurtured outlive their flamboyant creator?

80 A TALK WITH GIANNI VERSACE

The fashion mogul recently spoke with BUSINESS WEEK about globalization, going public, and Italian fashion

News: Analysis & Commentary

28 MCI-BT: A MERGER GONE SOUR?

The new numbers at MCI make its proposed linkup look like a disappointment for British Telecommunications

30 LESS GUSTO THIS TIME AROUND

Despite a few standout performances, big falloffs at companies like Chrysler make the second quarter a letdown

30 TECHNOLOGY'S GLORY DAYS

Strong PC sales are sending the sector to new heights

32 IS APPLE MINCEMEAT?

Maybe not—but it needs radical surgery to lure a top turnaround expert and create a sense of hope

33 COMMENTARY

It's time for AT&T's board to get serious about finding a replacement for Chairman Bob Allen

34 COMMENTARY

Even in the New Economy, the link between unemployment and inflation cannot be ignored

35 BANKING ON CONNECTIONS?

Suspicion mounts that some community banks got fed money because of their Clinton ties

36 A COZY DEAL AT BENETTON

The publicly owned apparel group's plan to buy the family's sports outfit raises questions about strategy

38 THE YANKEES' IRABU SHOW

Hideki Irabu may be a great pitcher. He's already a marketing phenom

42 IN BUSINESS THIS WEEK

International Business

46 GERMANY

Increasingly, workers are negotiating wage cuts and work rules as business struggles to compete

48 CHINA

The Chinese love Kodak film, but national pride might thwart a joint venture

51 INTERNATIONAL OUTLOOK

Japan: The LDP is riding reforms into political dominance

Economic Analysis

20 ECONOMIC VIEWPOINT

Roberts: With its mix of incentives and competition, Chile has found a way for welfare that isn't habit-forming

24 ECONOMIC TRENDS

Labor gets a bigger slice of the rebound in Canada's economy, but the value of a sheepskin

25 BUSINESS OUTLOOK

How long will the consumer spending lull last?
Canada: Happy days may head



PUSHER
Mark Willes
growth out of
firror?



HELPING HAND
Martha Stewart's
second-in-command
is a powerhouse,
too page 58



**SLIGHT
FALLOFF**
Profit
growth is
down a bit in
the second
quarter page 30



**SPACE
ODDITIES**
Out-there notions
on conquering
the last frontier
page 89



MONEY TROUBLE
Currency turmoil in
Southeast Asia page 66

REVOLVING DOOR
Blockbuster turns to
yet another chief—
and strategy page 101

ernment

INGTON OUTLOOK

Donorgate is spooking Democratic
's

E WORKS: A TAX-CUT DEAL

at the bipartisan bluster. A
promise seems likely before
ress takes off in August

Corporation

LETING TIMES MIRROR

ng made a champ of Cheerios,
Willes is trying to bring growth
e tired newspaper biz

ple

THA STEWART'S RIGHT ARM

Sharon Patrick turned America's
ite hostess into a full-fledged
rate entity

ance

HEAST ASIA'S CURRENCY CRISIS

leath of easy money spells an end
es of growth that have been the
of the world

71 COMMENTARY

Investors needn't worry about growing
U.S. reliance on foreign capital

73 INSIDE WALL STREET

111 INVESTMENT FIGURES OF THE WEEK

Information Processing

18 TECHNOLOGY & YOU

A rural Georgia teacher is successfully
using the Internet to turn her students
into scientists

84 WANT GTE? TAKE A NUMBER

The once-dowdy telecom lists AT&T,
Sprint, Cable & Wireless, and MCI
among possible suitors

88 THE INTERNET NAME GAME

As more companies lay claim to the
same electronic moniker, the entire
registration process may have to change

Science & Technology

89 THEY'RE GOING SPACE CRAZY

Theme parks on the moon? Mines on
asteroids? The private sector is floating
some out-of-this-world ideas

100 DEVELOPMENTS TO WATCH

A new drug source, reducing chemo's
side effects, thermoacoustic fridges

Entertainment

101 BLOCKBUSTER'S NEW SCRIPT DOCTOR

Can the Viacom video chain's third CEO
in just over a year stop its meltdown?

Personal Business

106 AUTOS: Car shopping on the Net

SMART MONEY: Cola and investors

Features

4 UP FRONT

10 READERS REPORT

10 CORRECTIONS & CLARIFICATIONS

13 BUSINESS WEEK BEST-SELLER LIST

16 BOOKS

Hacker: *Money*

109 BUSINESS WEEK INDEX

110 INDEX TO COMPANIES

112 EDITORIALS

What the strong dollar is saying
Old saws and the new economy

Up Front

EDITED BY LARRY LIGHT

MERGER MANIA

WALL STREET DEALS THAT AREN'T SO PRICEY

THE BANKING BIZ HAS MADE big buys on Wall Street recently, but some may not be as pricey as they seem—if a partnership is acquired. The big plus: Buyers can deduct the purchase price of a partnership on their taxes over 15 years, according to Lehman Brothers.

Take NationsBank's \$1.2 billion purchase of Montgomery Securities, a San Francisco partnership. Lehman's tax expert, Robert Willens, figures that NationsBank will pick up \$300 million in tax write-offs. And when Bank of America, in a deal structured a bit differently, bought Robertson Stephens for \$540 million, it nailed down \$295 million in deductions. In part, Bank of America is treating the buyout money it pays Stephens' part-

ners as a tax-deductible business expense.

The little-known tax break that NationsBank is using, created by Congress in 1993, shows how Washington favors partnerships by making mergers with them attractive. (It also taxes their profits more lightly than corporate dividends. Still, most securities firms are corporations, whose edge is that they can raise capital more easily.)

The tax-savings feature could boost buyouts of partnerships, says independent analyst Perrin Long. Some of Wall Street's best-known names are partnerships. Do Goldman Sachs, Alliance Capital, or Cantor Fitzgerald have a suitor in their future? Mum's their word. □



TALK SHOW "Mr. Foster committed suicide by gunshot at Fort Marcy Park, Virginia, on July 20, 1993."

—Report by Whitewater prosecutor Kenneth Starr, on the death of White House aide Vincent Foster



CAPITAL OFFENSES

BEER, BLUBBER, AND BOONDOGGLES

THIS YEAR'S TAX BILL, NOW IN heavy negotiations between Congress and the White House, has the usual crop of special-interest plums. Among the wackier items:

Frequent Jumper Fares: A few years ago, the Internal Revenue Service declared that skydivers were airline passengers and thus subject

WHAT GOES UP gets a tax break to a 10% tier tax—about \$60 per jump. Sky divers poi-

out that they should pay that because their flights aren't round-trip. So the state wants to charge them only the tax for the airfare fuel used, which is generally a lower bite.

Fat chance: Native Alaskan whaling captains traditionally throw a wingding after a hunt, which the blubber gets divided among the tribe. A Section 513 provision would give captains a \$7,500 write-off for outfitting their crews and throwing the party.

This Bud's für sich: If the chambers of Congress want to encourage U.S. beer consumption at Embassy law functions by making the beer purchases tax-free to foreign diplomats. The \$18-per-barrel excise tax amounts to about 5.5¢ a can. But it's hardly imagine German beer clubbists swilling Pabst Blue Ribbon. Roy Furchtgott

SPORTS BIZ

SUBPAR FOR THE GOLDEN BEAR

JACK NICKLAUS HAS BEEN A better golfer than businessman. His company, Golden Bear Golf, is down 29% from its offering price of 16 when it went public last August. The company, which operates practice centers and markets golfing gear, lost 60¢ per share last year and 29¢ in 1997's first quarter. Golden Bear mainly blames its slump on the 11 properties it bought in 1996, which have taken longer and cost more to re-
vamp than projected.

The 57-year-old golf legend,

who owns 55% of Golden Bear, is unveiling a marketing plan to help him get out of the rough. A former American Express pitchman, Nicklaus soon be seen in ads pushing a special Nicklaus Visa card that lets you enter a monthly sweepstakes. Grand prize: a round of golf with Nicklaus himself.



NICKLAUS: Help from Visa?

holders will shell out a \$50 annual fee to join an affinity program to win awards at every point on every dollar charged. Enough points get you lessons or clubs.

Merrill Lynch analyst Bryan Kissell doubts such alliances will have much impact on the bottom line. What do you have in your back pocket? Lisa Sano

THE LIST SHOP CITY



MALL OF AMERICA

The malling of America is on again after a slowdown earlier in the decade. Ten large malls—over 1 million square feet each—open every year, on average. Several existing behemoths recently completed expansions. And the gargantuan Mall of America outside Minneapolis celebrates its fifth anniversary in August.

LARGEST U.S. SHOPPING MALLS

NAME	LOCATION	SIZE*
MALL OF AMERICA	BLOOMINGTON, MINN.	4,200,000
DEL AMO FASHION CENTER	TORRANCE, CALIF.	3,000,000
SOUTH COAST PLAZA/CRYSTAL COURT	COSTA MESA, CALIF.	2,900,000
WOODFIELD MALL	SCHAUMBURG, ILL.	2,700,000
SAWGRASS MILLS	SUNRISE, FLA.	2,350,000

*Gross leasable area in square feet

DATA: INTERNATIONAL COUNCIL OF SHOPPING CENTERS

Do online services still matter?

CompuServe Inc.

CSi (CompuServe)



While AOL and MSN attempt to fend off the ISP hordes with splashy graphics and television metaphors, CSi 3.0, the online service formerly known as CompuServe, **refocuses on the fundamentals of what makes a strong online service. CSi provides dependable connections, e-mail delivery, well-attended hosted forums, Internet access, and an improved user interface.** It may not offer the same pop-culture jolt as its competitors, but with its periodicals databases, CSi delivers the **valuable information business users need.**

...but its sheer depth and value are unparalleled by online service competitors or by the Web. Particularly notable are CSi's fee-added services, which offer incredible research value simply not available elsewhere. The volume of content and being able to search easily for what you need make these offerings standout features.

One example is Newspaper Archives, where you can browse full-text archives of 55 daily newspapers—more

Evidently, CompuServe does.

While the Internet delivers a lot — you won't find everything there. That's why so many people rely on CSi (CompuServe) to deliver today's richest collection of online content — content you can't find anywhere else. It's also why we earned the 1997 Editors' Choice Award from *PC Magazine*.

Whether you're after ways to improve your home PC's performance, advice on today's best performing mutual funds, or seamless Internet access, CSi delivers what you need, when you need it.

Find out for yourself why at least one online service still matters. Call 1-800-375-7969 for the latest version of CSi software and 10 free hours.



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PHONE WARS

BELL SOUTH DROPS A DIME ON AT&T

AT&T IS A GREEDHEAD THAT sticks it to consumers. So says Bell South in the telephone wars' latest skirmish. At issue: a Federal Communications Commission order that required the Baby Bells by July 1 to reduce the access charges they levy on AT&T and its brethren for transmitting long-distance calls to customers.

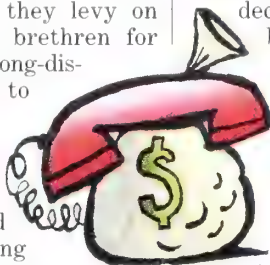
Bell South points out, in high dudgeon, that AT&T did not pass along the reductions to consumers until July 15. The result of the 15-day delay: \$36 million in savings for AT&T. While that may seem a pittance compared with AT&T's \$5.6 billion 1996 net income, Bell South thinks the access-charge windfall has great propaganda value.

AT&T says it passed along

the rate reductions as soon as logistically possible. Indeed, some of the delay is a result of the Bells' inability to adjust their billing systems quickly to accommodate the change, says AT&T. This year's access-charge reductions will decrease by about \$1.7

billion what the long-distance companies pay the Bells (1996 total: \$23 billion).

AT&T spokesman Mark Sigel says his company's access-charge discounts, now in place, are a boon to customers, slicing day and evening calling rates by 5% and night and weekend rates by 15%. The long-distance carriers say that they could be more generous still to the public, if only they could get into local-calling markets—but that the mean Baby Bells won't let them. *Catherine Yang*



COLLECTIBLES

HARD ROCK IN A HARD PLACE

HARD ROCK CAFE, THE worldwide chain of music-themed family restaurants, is known for its displays of rock 'n' roll memorabilia. Now in 76 locations around the globe, Hard Rock plans to open

prices of *objets d'rock* higher than a Deadhead on Maui Wowie. Take Jimi Hendrix' famed V-shaped guitar, Flying Angel, on display at the chain's London eatery. Hard Rock bought it for \$15,000 in 1985. Now, the company says, it is appraised at \$250,000.

To afford more stuff, says marketing veep Steve Routhier, Hard Rock is speculating in little-known current acts in

hopes they will make it big. So he bought a

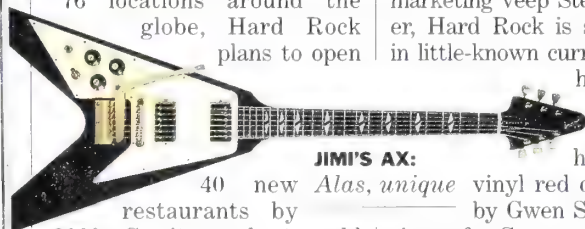
JIMI'S AX:

40 new Alas, unique vinyl red dress worn by Gwen Stefani, lead

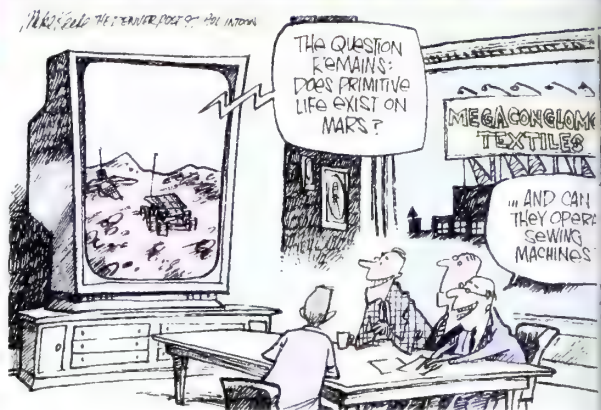
restaurants by 2000. So it needs to add 10,000 rock knickknacks to its collection, which includes everything from the Beatles Magical Mystery Tour bus to a guitar the Surfaris played on their one hit, *Wipe Out*.

But private collectors and Cleveland's new Rock and Roll Museum have bid up the

singer for Grammy-nominated band No Doubt. And he snapped up an autographed jacket from Better Than Ezra and signed posters from Radio Head—two groups that have had a couple of hits between them. Who knows? They might be the next Surfaris. *Roy Furchgott*



DRAWN & QUARTERED



MAIL SACK

IT'S JUNK, BUT IT MEANS JOBS

LOTS OF AMERICAN UNIONS claim they've heard the giant sucking sound of jobs going to Mexico—but postal workers? The American Postal Workers Union is upset about some 1,300 Mexican workers who put bar codes on junk- and other mass-mailing envelopes, such as bills, in three border plants. "These workers are getting \$4 a day," says Moe Biller, union president. He met with Mexican labor leaders recently to find a way to raise wages at the plants.

The fracas stems from the discounts the U.S. Postal Service began a year ago, giving 5¢ to 8¢ off the normal

32¢ rate for presorted mail it includes a bar code. Some private mail-processing companies—MailCode, Postnet and ElectroCom—got her into bar coding. A lot of work is automated and can be cheaply done in the U.S. The Mexicans focus on the labor-intensive job of coding envelopes with smudged, complicated addresses.

The union says the bar coding technology developed by the USPS, should be used to work to Mexico. The mail processors argue that their Mexican operations have cost one American

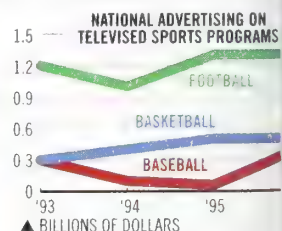
job, since this is a competitive business. The union fears that with the ever-growing mass-mailing pile, Post Office jobs could eventually be threatened. *Elisabeth M...*



THE BIG PICTURE

BASEBALL'S STRIKEOUT

Baseball might be the national pastime, but it's not a big draw for television advertisers. The 1994-95 strike made things worse. Basketball's high energy has led to steady growth. And good old brutal football, with its flashy Super Bowl, still captures top dollar from Madison Avenue.



FOOTNOTES

Investors planning to monitor market news while on vacation: 90%; planning to call their broker: 20%

BREAKTHROUGH PRODUCTS?

*Actually, our greatest innovation
is the reinvention of the company itself.*

Over the years, NEC Technologies has been responsible for some of the most important breakthroughs in the field of high technology. And not surprisingly, we have garnered some of the most important awards in the industry along the way as well.

Yet, if we dare say so ourselves, our most important innovation may just be the reinvention of the company itself.

Today, NEC Technologies is truly a new organization. An exciting one. A company whose employees believe that expectations were meant to be exceeded.

At the new NEC Technologies, we're more committed than ever to developing the essential technologies that will support and inspire the

Developed the first multiple-frequency monitor

1985

Introduced the first flat square technology CRT

1986

Pioneered Reduced Magnetic Field™ technology.

1990



Launched the LCD1280™, the first full-color active matrix TFT liquid crystal display.

1993

The industry's first 3-year limited warranty

1993

The first to use power management software

1993



The first Plug and Play compatible monitor

1994

How do you know if you're buying a genuine NEC Technologies product? The NEC Technologies mark assures you that you are buying a premium quality product that is only available from NEC Technologies.

1997



The SuperScript™ 1260 is a cross-platform printer that fits into all major network environments.

1997



The MultiSync® LCD2000™, the first commercially available 20.1" viewable LCD monitor.

1997



The lightweight, reliable, easy to use MultiSync MT1000™ LCD projector is one of the keys to giving a worry-free presentation.

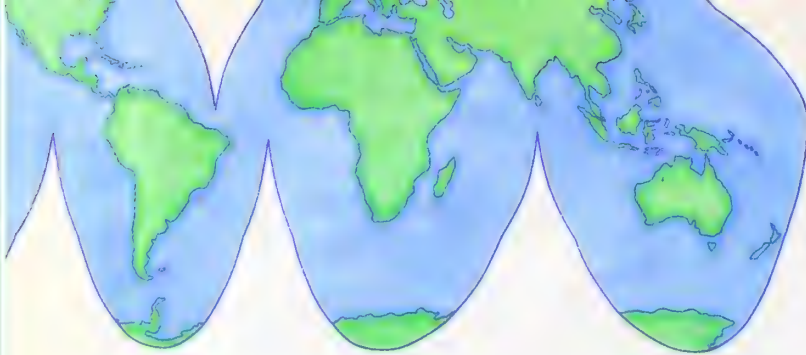
1997



MultiSync Enterprise and Advanced Series are the monitors for people looking for superior, lifelike images.

1997





AIDS IS A GLOBAL EPIDEMIC. More than 20 million men, women and children are currently infected with HIV worldwide. In the U.S. alone, 0.5% of 15-to-45-year-olds have HIV/AIDS. In developing nations, the infection rate is even higher, robbing tens of thousands of people of their loved ones every year.



LOOKING AT

DATA is never

enough. You need to

look beyond, which David Ho

does on an NEC Technologies

MultiSync® LCD2000™ 20.1"

viewable LCD monitor. After

discovering that the virus is more

active than originally thought,

Dr. Ho formulated a very aggressive

approach. He administers

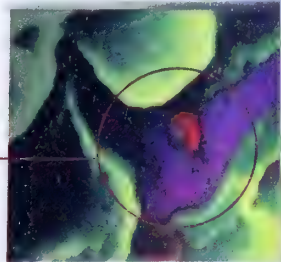
a powerful mix of protease

inhibitors with traditional

antiviral drugs very early on.

**How do you
envision a future
for those who
can't see one for
themselves?**

THE AIDS VIRUS (MAGNIFIED)



NEC

GoGo

THE AIDS QUILT was designed to raise awareness of this insidious disease, as well as to honor its victims. Each panel is the result of love and caring, and many carry messages to the ones they've lost. Seeing the entire quilt in one place is a profoundly moving experience. Sadly, however, it's being added so quickly that it's doubtful that it would fit here today.



picture a world without
we Ho can. Last year,
the Aaron Diamond AIDS

Center in New York City announced
innovative approach to treatment.
y, this discovery might actually
the virus from patients' blood if
se is detected early enough.

the new NEC Technologies, we salute
ed his colleagues for looking beyond,
feel very honored that some of our
are being used in his laboratory.
him. We believe that expectations

ant to be exceeded,
as two decades ago
pioneered the then



NEC MultiSync LCD2000
20.1" Viewable LCD Monitor

revolutionary concept of inte-
grating computers with communication.
Today, that mission has been realized with
the advent of the true multimedia age.

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like liquid crystal display monitors, smart
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nologies – products which don't just give
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deliver an experience that gives you a better
window into your world.

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DR. DAVID HO
AND HIS
COLLEAGUES

at the Aaron Diamond AIDS
Research Center in New York
City have been tirelessly working



with other researchers around
the world to solve this medical
mystery. Dr. Ho will be the first
to tell you that his work is very
much a team effort. He will
also be the first to remind you
that no breakthrough, however
promising, is a replacement for
responsible behavior.

THERE IS HOPE. Dr. Ho's approach was actually able to reduce the level of HIV
in patients' blood to the point where it couldn't be measured. The expectation is that
after a few years of such treatment, the virus might be eliminated entirely from this
patients. Naturally, this is not a "cure," and there is still a tremendous amount of work
But for once at least, it appears that the AIDS virus has blinked.



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NIKE HASN'T LEARNED ITS LESSON

As a long-standing critic of Nike Inc.'s Asian production practices, I applaud Linda Himmelstein's observation that Andrew Young did a disservice to Nike by failing to address some key issues ("Nike hasn't scrubbed its image yet," *News: Analysis & Commentary*, July 7). Young's GoodWorks International may have made a significant contribution, however, by providing a good example of what "independent monitoring" isn't. In the coming months, President Clinton's apparel-industry partnership will unveil its plan for monitoring factories. As GoodWorks' facile report makes clear, this monitoring must include survey work done by indigenous groups the workers trust, not using factory walk-throughs with a few ritual visits to local worker-rights groups.

Jeffrey Ballinger
Alpine, N. J.

LEAKS? NOT AT MONTGOMERY SECURITIES

I have grave concerns about your reporting on how we use research at Montgomery Securities ("Love among the heavyweights," Finance, July 14). We do not "leak research reports to favored clients," a point I emphasized repeatedly in an interview. Leaking research is an illegal and unethical activity. Were we to find an employee guilty of such activity, that employee would be dismissed and his activities reported to the authorities. The authorities have never charged us with that type of unethical distribution of research. To allege it is absurd given how we have been able to grow our brokerage business.

We would not be the eighth-largest brokerage in the U.S. (based on an independent survey of institutional commissions) if we condoned giving some clients advantages over others, as you suggest.

Thomas W. Weisel

Chairman and Chief Executive Officer
Montgomery Securities
San Francisco

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CORRECTIONS & CLARIFICATION

"Love among the heavyweights" (Financial Times, July 14) reported incorrect underwriting rankings for Montgomery Securities. Judged by the stock market performance of the companies Montgomery brought public, it ranked 18th in 1995 and 1996, not 25th, according to Securities Data Co. (SDC). This correct ranking excludes firms that did only one or two deals. Furthermore, Montgomery's equity underwriting ranking for the first half of 1997—based on dollar volume—was 11th, not 13th, according to SDC.

"The Biology of Business" (Books, July 4), should have said Sumitomo was a Japanese company, not South Korean.

In a table accompanying the article on stocks in the midyear investment outlook ("How to play this market," Cover Story, June 16), the price of Arbor Software stock should have been 29%, not 39%.

THE DIGITAL FRONTIER'S OVERLOOKED PIONEERS

We at SRI read with interest the article "The digital frontier" (Cover story, June 23). For more than 30 years SRI International has collaborated and competed against many of the search labs that were profiled.

SRI has made significant contributions to the origins of personal computers and computer networking. In the 1960s, Douglas Engelbart and his team at SRI developed the first foundations of personal computing. The first graphical display of this revolutionary character came in the fall of 1968 with adjustable cathode-ray terminal display terminals, remote collaborative computing enabled by video window exchange and shared electronic displays; hypertext links; online help; and even the mouse.

SRI has some of the earliest patents on modern technology. We developed optical-disk recording and playback at 3M in 1963, built the first secure ta-

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shared operating system, and created one of the first mobile robots capable of observing and reasoning about its environment.

William P. Sommers
Chief Executive Officer
SRI International
Menlo Park, Calif.

"The digital frontier" neglected the U.S. Energy Dept.'s national labs, which, together with the Energy Dept., have an annual research and development budget of more than \$16 billion. The U.S. government supports more than 735 laboratories through various departments and agencies. The total federal budget for laboratory R&D is about \$60 billion annually. NASA alone has 12 large laboratories for R&D, much of it related to digital work.

Finally, most of the university researchers in the digital field are either connected to these laboratories or have close colleagues who work in them. In fact, due to the premier facilities and equipment at most of these labs, much of the university researchers' actual experimentation is done at the national labs, and it involves graduate students as well.

Woodrow W. Clark Jr., Manager,
Strategic Planning, Energy
Lawrence Livermore
National Laboratory
Livermore, Calif.

TELECOM WARS: A FEW CLARIFICATIONS

Amy Barrett's Commentary ("Regulators should discipline telecom brats," News: Analysis & Commentary, June 30) was off the mark. She lumps seven

completely different companies together and then tars us all with the same brush.

Ameritech Corp. launched the objective of a fully competitive telecom marketplace in 1993, with our Customers First filing to the Federal Communications Commission. But Barrett leads readers to believe otherwise. She then closes her case by asking regulators to deal forcefully with those who block competition. In fact, it is regulators who have the power to deliver the kind of competition the telecom act intended. All they have to do is pull the trigger—and those of us straining behind the starting gate will be off like a shot.

Kelly Welsh
Executive Vice-President
and General Counsel
Ameritech Corp.
Chicago

Since I am acutely aware of the intricacies of wireless-communications competition in New York City, I am compelled to take issue with some statements made in your column on the New York wireless marketplace ("Cell phones: More, better, cheaper," Personal Business, May 26).

For example, wireless calls made on cellular networks are not "frequently dropped," as the article indicated. In fact, calls on Bell Atlantic Nynex Mobile Inc.'s advanced network are dropped less than 2% of the time, significantly lower than the "new" competing wireless personal communications system (PCS) providers.

And numerous wireless data applications with analog technology have been available for years, including wireless fax, E-mail, Internet access, remote dispatch, and virtually instantaneous credit-card verifications, to name a few.

You should also know that Bell Atlantic Nynex Mobile has all but eliminated security weaknesses through the use of advanced encryption technology.

W. Richard Conrad
President
New York/New Jersey
Metropolitan Region
Bell Atlantic Nynex Mobile Inc.
Orangeburg, N. Y.

In your recent spate of commentaries on the failure of federal telecommunications legislation, your readers received only the views of spin doctors bent on thwarting competition in long distance.

The assertion that the regional Bells are forestalling local phone competition is blatantly false. This is the big lie per-

petuated by the long-distance industry. Also, your assertion that technological innovation is stalled is ridiculous. In business customers have wide choice of telecommunications service. Competition for data service is robust between cable and local phone companies. Bell Atlantic is constantly rolling out new services and competitive price packages.

The threat of local rates hikes, raised in BUSINESS WEEK, is just as ludicrous. Bell Atlantic hasn't raised basic residential rates a cent since the passage of the Telecommunications Reform Act of 1996. And we won't, because the rates are capped almost everywhere.

James G. C...
Vice-Chairman
Bell Atlantic Corp.
Arlington, Va.

WHAT THE AVIAN WORLD CAN DO FOR BUSINESS

Your article on the business of birding was great ("Tracking America's winged beauties," Personal Business, June 30). However, you neglected the supply side. That is, where do the birds come from?

The natural habitats that produce birds are under constant threat. Contrary to the beliefs of many business people, a healthy environment is good for business. Birds are, as your article points out—good business. And not just for the mechanical tool of the trade, either. Birders travel and spend money for food and lodging, Birdseed, feeders, books, magazines, computer software, and communications equipment are in the budgets of many birders.

Donald A. Win...
Norwich, NY

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HOT TYPE

YOU'RE A COLLEGE BASKETBALL COACH, AND you've just led your team to the finals in a row. Then you quit and accept a \$70 million contract to revive the most storied team in pro hoops. Not a lot of time for a book advising people how to succeed, eh? That's exactly what new Boston Celtics honcho Rick Pitino has done with *Success Is a Choice*, the No. 3 hardback on this month's best-seller list. He offers fairly standard motivational fare: Believe in yourself, set realistic goals, work hard, stay positive, and never be totally satisfied. "You must eliminate the word quit from your vocabulary," Pitino urges. Highlights include Pitino's description of specific steps he has taken over the past two decades to turn around four moribund

or troubled college- and pro-basketball programs. Remember Billy Donovan? Pitino tells how he helped turn the pudgy kid into a national star for Providence College in the late '80s.

The book stumbles, though, in asserting that people have complete command of their destinies. "We control our life," he writes. "We alone have the power." Even Pitino—maybe unwittingly—realizes that's a bit much. Fifty pages later, he says: "There are so many things we can't control," such as injuries, the weather, and the world economy. What we do control, he then says, are our moods. He may find his own spirits flagging this year as he tries to help the woeful Celtics recapture their lost glory. Then again, it's hard to bet against him.

BY DAVID LEONHARDT

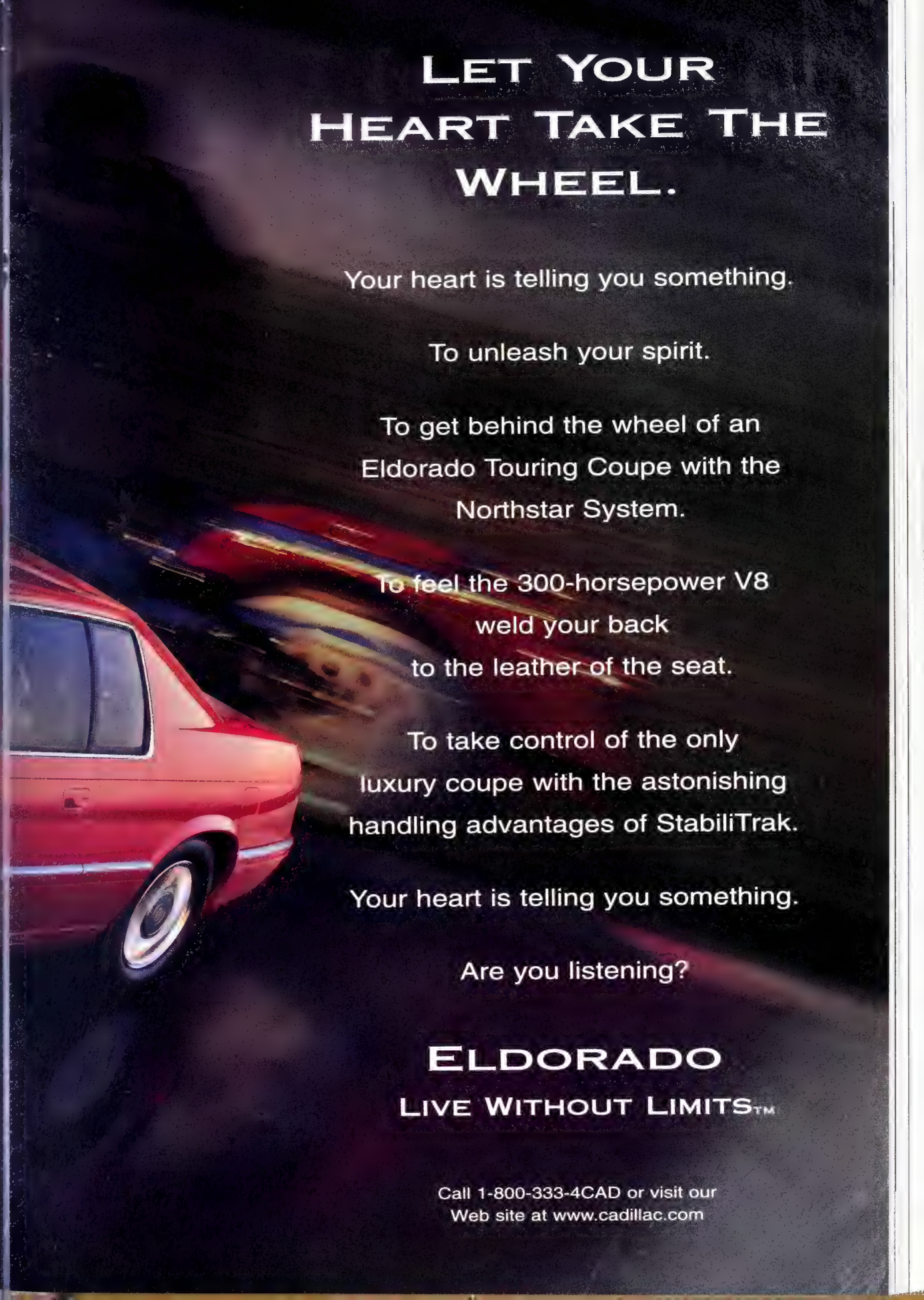


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MONEY

Who Has How Much and Why

By Andrew Hacker

Scribner • 254pp • \$25

THEM THAT'S GOT SHALL GET

Americans have an ambivalent attitude toward money. Many people never talk about how much they earn, even with friends or colleagues at work. Yet we're fascinated by how much everyone else makes and spend plenty of time following the conspicuous spending of the Donald Trumps of the world.

Andrew Hacker feeds Americans' fascination with the power of the purse in *Money: Who Has How Much and Why*. Hacker, a political science professor at Queens College in New York City, draws broad conclusions that are well-known: Wealth and income in the U.S. are distributed unequally and sometimes almost arbitrarily, trends that have become more extreme in recent decades.

As a snapshot of American society, *Money* does not treat questions of economic mobility. Still, Hacker has done an excellent job of gathering a wealth of facts and stats and bringing the numbers to life.

Not surprisingly, Hacker looks most at the wallets of those at the top. He defines the rich as those pulling down \$1 million or more a year, a group made up of 68,064 households in 1994, the last year for which he had data available. That works out to one-twentieth of 1% of all Americans who filed a federal income-tax form that year.

So do the rich pay their taxes? Sure do, Hacker finds, contrary to the impression left by public figures who've paid no taxes in some years. They

forked over 32% of their declared income to the feds, a larger percentage than the less fortunate (assuming the wealthy actually declared all income). On the other hand, that's below what the \$1 million club paid before President Reagan ushered in an era of tax-cutting. In 1979, the group coughed up 47% to the Internal Revenue Service. Another nonsurprise: rich don't work for their money. They get just a third of their income from employment, with the rest coming from earnings off the assets they hold, as interest, dividends, and rent.

What is surprising is who they are. Sure, they include all the top you'd expect: a few hundred movie stars and sports figures, perhaps 1,500 Wall Street bankers, a sprinkling of lawyers and doctors and, of course, top execs. But even the last group numbers only 2,500 or so, Hacker says. The other 60,000-odd millionaires are anonymous, mostly owners of small businesses and heirs to fortunes. A big chunk are retirees: About 10,000 cashed Social Security checks, which anyone, even billionaires, can do once they hit age 62 (when all income limits disappear).

Hacker's sleuthing has unearthed

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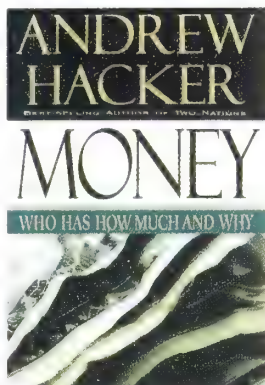
At some point you'll launch Netscape, you'll exchange email with people inside and outside of your company and, all of a sudden, it will hit you. The enterprise email and groupware solution that you've been looking for is closer than you think.

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y of other tantalizing tidbits about lifestyles of the rich, if not always as. They seem to value family, since of millionaire households include tied couples, vs. 55% for the country whole. But cast-off spouses don't ly get the royal treatment. The rich households that alimony dished out an age of \$61,000 a year—than 3% of their average annual income. Nor are rich more generous it comes to giving to other than family. itable donations average \$61,000 a year as well, in percentage terms many Americans of means," Hacker says. millionaires also are happy to accept subsidies from r taxpayers. Sixty percent take age deductions. These average 00 a year, "which means that other ayers are underwriting a lot of tree-lined driveways and tennis courts," er says. A few even take child-credits and deduct moving expenses from taxes.

what about the rest of us? Physi-



cians have held the best-paying jobs for most of this century, Hacker notes. Three-quarters of private practitioners net more than \$100,000 a year, and a third of all doctors make at least double that. Lawyers are a more diverse lot, with a third making above \$100,000 but 22% earning \$40,000 or less. College professors are even more unequal. They make just \$44,000 on average. But tenure has divided their ranks. "Because of their top-heavy pay, senior professors consume so much of the college budget—in some schools, three-quarters of instructional costs—that little remains to hire junior people," Hacker writes. And even full professors are split. Just 3% earn more than \$100,000 a year, while five universities average that much for their senior professors: Harvard, Stanford, the California Institute of Technology, Princeton, and Yale.

Hacker shows how this trend toward heightened inequality has spread throughout the economy. Perhaps the most glaring example involves race. The

ranks of black families earning more than \$50,000 a year have jumped dramatically in the past two decades, from 14% to 21%. But this happened because blacks in the middle moved up, not because the bottom changed. In fact, 30% of black families earn \$15,000 or less today, scarcely different from the 32% stuck at that level in 1975, after inflation adjustments. And blacks are still often shut out of higher-wage occupations. For example, they comprise about 11% of all workers but less than 5% of dentists, architects, engineers, and lawyers.

As a result, black families on the whole have lost ground, despite affirmative action. Today, black families make \$577 for every \$1,000 that white families earn, vs. \$605 two decades ago. Only half of the gap can be attributed to differences in education, marriage rates, and other demographic factors. The rest presumably lies with prejudice and discrimination. "Something like this should not happen," Hacker asserts.

Hacker laments today's heightened inequities. But he doesn't think they're likely to reverse any time soon.

BY AARON BERNSTEIN
Workplace Editor Bernstein tracks inequality issues for BUSINESS WEEK.



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A CLASS ACT ON THE NET

A Georgia teacher tells how she got her students on the Web—and wild about science

For the past seven years, Rhonda Toon has been an elementary-school teacher in Lamar County, Ga. In response to the June 9 column "Readin', Writin', and the Internet," she wrote this account of her struggle to get her students onto the Internet. For more from the front lines of education, check out www.businessweek.com/tocsteched.htm.

At my rural Georgia school, over 60% of the students receive free or reduced-price lunch, and many of them know little of the world beyond our county. Textiles still play a part in the local economy, but mill closings have devastated many families.

My task as a teacher is enormous. How do I expose these children to the wonders and opportunities available to them? How do I keep bright, talented children focused on education?

One way has been to use technology. For six years, I have had the Internet in my classroom. I have never received any formal computer training. I did what many people do: I purchased a home computer and began to see the classroom applications it could have. But to get the Internet to my classroom, I had to write grant proposals, beg, and borrow. My first grant was \$500 from BellSouth. I thought it could wire my room, buy the modem, and pay for telephone and Internet service. I will never forget pleading with the customer-service representative who said I would have to pay the more expensive business rate. I offered—seriously—to sleep in my classroom several nights per week.

I scaled down my plans, the school put up some money, and I went ahead with my first project: Fourth-graders solicited questions from students and submitted them to researchers at Georgia Tech. My students retrieved the answers and aired them over the school's closed-circuit TV system.

DAILY DRILL. A BellSouth grant kept this exchange going for three years. Then my modem was stolen. I won a state award for the Georgia Tech program, and the prize money kept me funded a little longer. A grant from Vice-President Al Gore's Global Learning Observations to Benefit the Environment (GLOBE) paid for a new, faster modem and Internet service. Now I could reach the World Wide Web, and a door of opportunity opened.

My students began to use the Internet like an encyclopedia. I knew the Net had become part of the daily routine when

bad weather threatened a field trip and a student suggested we check the National Weather Service on the Internet. At the planetarium, Megan, one of my girls, interrupted the tape downloading images to ask: "Is that ProComm Plus you're using?" When the surprised speaker answered "yes," Megan said, "I use that at school." He invited her to demonstrate, and Megan easily downloaded an image from a remote observatory. I was so proud.

The program that has brought the most change in my classroom is Passport to Knowledge (PTK), sponsored by NASA and the National Science Foundation. Kids get to work with working researchers. They read their journals online, ask their questions answered, and watch researchers on closed-circuit TV from such places as Antarctica, aboard aircraft in the stratosphere, or at the Jet Propulsion Laboratory.

PTK includes hands-on student activities. My students have constructed aircraft to hold eggs and dropped them from cherry-pickers to simulate the work of NASA engineers. They have submersed their hands in icy water to study the effects of the cold at the South Pole. The PTK crew has helped me

become a better teacher. But most important, they have helped me show rural kids in Georgia that they can become scientists.

It has caused me much pain that such access is not available to all the students at my school. Last year, I decided I had to do something. I wrote letters, made calls, and attended state Day meetings. With the sponsorship of BellSouth, all the teachers will soon have Internet access in their classrooms, and every child will be able to go on electronic field trips to Mars or Antarctica. It concerns me that there are many school systems like my school where this is not available.

This past year, as my concern about the need for technology integration has grown, I have gone a step further, leaving the classroom to become a regional coordinator of the Gordon



WORLD WIDE VIEW

My kids get to know

working researchers—and take virtual field trips to Antarctica

AUTHOR TOON: NOW SHE'S TRAINING OTHER TEACHERS

Georgia Youth Science & Technology Center. I will train teachers to use technology in their lessons.

This country has plenty of willing and able teachers, but they need resources. I know what it is like to have kids come into my room and not be able to name a single scientist. And I have cried when I have had students—after participation in the PTK projects—list not only the names of the scientists they met through this program but their classmates as well. They now see themselves and each other as scientists.

America needs a scientifically literate populace. The use of technology can help us achieve this goal.

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BY PAUL CRAIG ROBERTS

WELFARE DOESN'T HAVE TO BE HABIT-FORMING—JUST LOOK AT CHILE



INCENTIVES:
The Chilean system offers training and tiny income subsidies. People are expected to work and look after themselves

Welfare systems have failed everywhere—except in Chile, a Second World country that has only recently emerged from Third World status. Why can Chile make welfare work, but not the U.S., France, or Germany?

The answer is that in Chile, welfare is neither an entitlement nor an open-ended expenditure, and the system is carefully crafted so that it does not result in dependency. Welfare goes to those who help themselves, and it cannot become a lifelong crutch.

Consider the housing subsidy. There are a reasonable but limited number of these each year. The subsidy takes the form of a grant toward the purchase of a house. The grants are open to competition. To enter the competition, a person must have accumulated private savings. There is a point system, and those who accumulate the most points have the best chance of receiving the subsidy.

Ernesto, a cab driver, described to me how he had become a homeowner. In 1990, he opened a special savings account in a private bank for the purchase of a house. For the next five years, while driving a cab, he managed to save slightly more than the agreed monthly amount, thereby demonstrating determination, discipline, and commitment. By 1995, his savings gave him a good standing in the point system, and he succeeded in his application for the subsidy.

The combination of his savings and the subsidy allowed him to obtain a mortgage for which he could afford the monthly payments. Because the housing subsidy rests on personal sacrifice and private ownership, low-income housing in Chile is not in the run-down condition of public housing in the U.S.

LUNCH SUBSIDIES. Chilean unemployment policy also places primary responsibility on the individual. There are no unemployment payments as such. Instead, there are training programs financed by the Labor Ministry and tax incentives for private companies. The beneficiary receives a three-month course during which he or she receives a subsidy to cover lunch (the main meal of the day) and transportation. Women who can read and write and are heads of households are provided with child care and with a monetary payment while undergoing on-the-job training. The training programs are designed to help dislocated workers and those people seeking jobs for the first time.

At the municipal level, there is a subsidy available for low-income, unemployed students. According to a Planning & Cooperation Ministry official, the amounts are kept low so as not to foster dependency. The number of recipients of the subsidy is declining. In short, Chileans are expected to work and look after themselves and their families.

A compassionate North American might dismiss Chile's welfare system as the product of a Latin American country and fail to appreciate its advantages in preventing the formation of welfare dependencies. The Chilean system is the craft of the military government, which had no need to buy votes with handouts. With its flock of University of Chicago-trained economists—the "Chicago Boys"—Chile's military government was the best-advised government in the world. The economists understood the blind alleys of compassion and the benefit of incentives to prod people to success.

FRUSTRATED. After putting in place a constitutional order and a privatized economy, the military government stepped down. Since 1990, the country has been under democratic rule, and its politicians are finding that the way Chile is constructed, they have little to sell to the electorate for votes. Frustrated, the politicians are expanding welfare programs, and there is legislation before Congress that proposes to establish unemployment insurance.

Chile's unprecedented prosperity and employment make these programs unnecessary, and the introduction of social welfare programs that have failed even in the most economically advanced countries will harm the long-term prospects of Chile and its citizens. However, the programs do serve the interests of politicians, who feign compassion until they carve out welfare dependencies to ensure their political futures.

In the 1970s, New York City argued that federal subsidies for its welfare system were the grounds that the city attracted a disproportionate share of poor people. The city did not understand that its system of welfare benefits, generous relative to other places, both attracted and created poor people. Compassion and politics made the city blind to economic incentives. With any luck, Chilean politicians will perceive the self-interested nature of their offerings and continue on the same course of success.

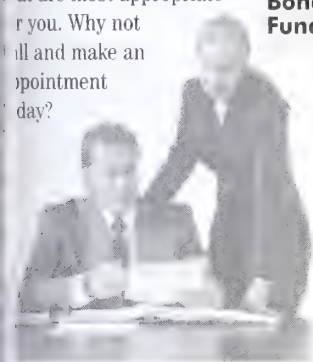
Paul Craig Roberts is John M. Olin Fellow at the Institute for Political Economy in Washington, D.C., and Research Fellow at The Independent Institute in Oakland, Calif.

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	★★★★★ Among 1,229 Taxable Bond Funds	Prudential High Yield Fund (Class A) Maximize current income	Takes a diversified approach to seeking high current income and solid credit quality from non-investment grade corporate bonds.
U.S. Bond Funds	★★★★★ Among 1,299 Municipal Bond Funds	Prudential Municipal Bond Fund/High Yield Series (Class A) Maximize income free from Federal income taxes*	Uses extensive credit analysis to select a diversified portfolio of investment grade and non-investment grade municipal bonds.
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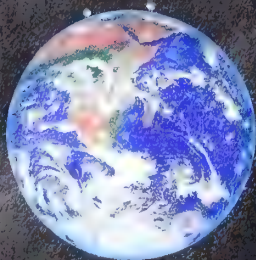
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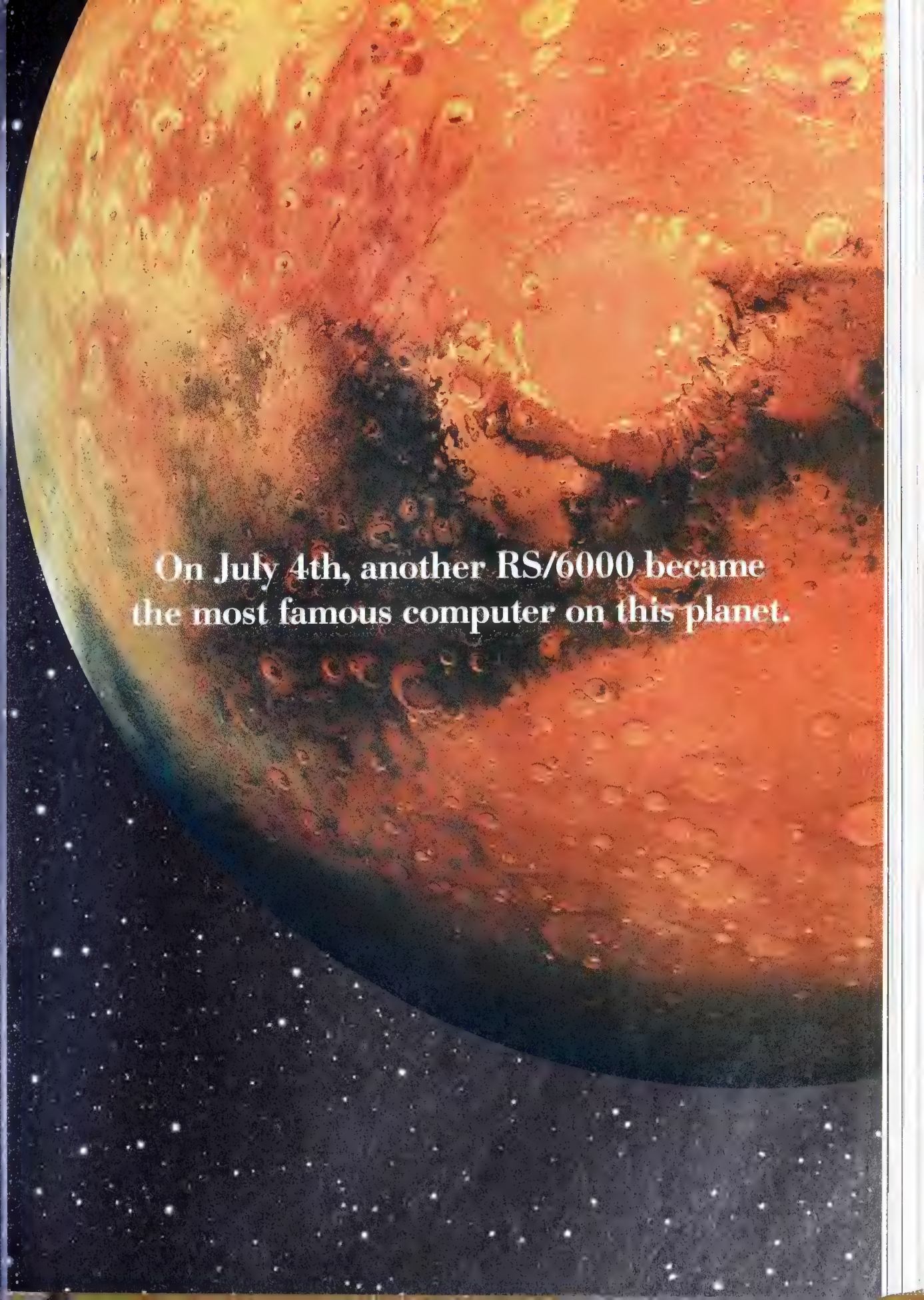
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On July 4th, another RS/6000 became
the most famous computer on this planet.

BY GENE KORETZ

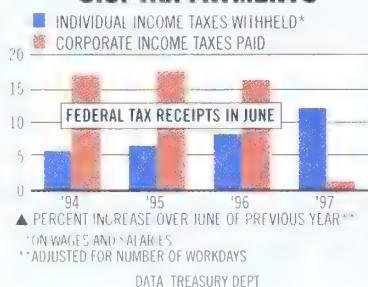
WORKERS GET MORE OF THE PIE

That's what new tax data suggest

When the federal government's tax receipts for June were totaled, they turned out to be so strong that economy watchers began sharply lowering their deficit estimates for fiscal 1997. The betting now is that the deficit this year could fall to \$50 billion, far below the Congressional Budget Office's projection of \$120 billion last January.

But the real news, according to economist Joseph Carson of Deutsche Morgan Grenfell, was buried in the data on the sources of government revenues. "Tax receipts are a sensitive gauge of economic activity," he says, "because they are the hardest of all data series—mainly reflecting taxes paid on income generated from current production."

A SHARP SHIFT IN U.S. TAX PAYMENTS



In June, notes Carson, the strength in tax receipts was on the individual and not the corporate side of the equation. Moreover, the fact that the biggest gains over June of last year were posted by withheld taxes rather than estimated tax payments suggests that the revenue surge was tied not to capital gains but to increases in labor earnings.

Indeed, withheld tax receipts, which usually rise in line with wage and salary income, are rising far faster this year—up about 9% over 1996, vs. 7% or so for reported wage gains. "Apparently, employment growth and growth in wages and hours have all been understated this year," Carson says.

That's not all. Carson points out that in June, for the first time in the current expansion, federal withheld tax receipts showed a larger year-over-year gain than quarterly corporate tax payments, which reflect companies' estimated tax-

es for the second quarter (chart). Adjusted for the number of workdays in the month, the rise in withheld tax receipts was 12.1%, vs. an anemic 1.3% rise in corporate tax collections. Unadjusted, the rise was 17.7%, vs. 6.4%.

This dramatic shift in tax receipts, says Carson, suggests not only that labor markets and wage gains are strong but also that a greater share of income from current production is now flowing to workers and less to companies. The upshot, he concludes, is that "the shrinking federal deficit—which might signal declining interest rates in other circumstances—appears more and more likely to be accompanied by rising ones."

THE MAPLE-LEAF MIRACLE

What's behind Canada's turnaround

With its jobless rate down nearly a full percentage point since November, Canada is finally turning in the kind of broad-based growth economy-watchers have been expecting (page 26). But the nation's most significant achievement, according to Toronto-based economist Michael Gregory of Lehman Brothers Inc., is the structural shift highlighted in its economic accounts for the first quarter.

For the first time since quarterly national accounting began in 1947, notes Gregory, final sales to business surpassed final sales to government. Private-sector spending on capital goods and structures accounted for a record 21.2% of gross domestic product in the first quarter. At the same time, total government spending on goods and services fell to just 20.6% of GDP, its lowest level since the 1950s.

Several factors lie behind this turnaround: the avid pursuit of price stability by the Bank of Canada, tax changes favoring business investment, and, perhaps most important, aggressive downsizing by all levels of government. Indeed, the latest national accounts indicate that the combined fiscal deficit, which hit a huge 8.2% of GDP in early 1993, has turned into a surplus of 0.1% of GDP—the first such positive showing in more than two decades.

By yearend, predicts Gregory, both federal and provincial governments will be net redeemers of debt, contributing to a triple legacy that should bolster the Canadian economy for years to come: smaller government, disappearing debt, and increased competitiveness.

SHEEPSKINS ARE GOLDEN FLEECE

How degrees ratchet up earnings

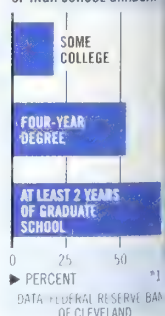
There's no question that going to college pays off in terms of higher earnings. But in a study in the Federal Reserve Bank of Cleveland's *Economic Review*, researchers Peter Rugg, Mark Schweitzer, Eric Severance-Lossin, and Erin Turner report that the financial benefits are often exaggerated. That's because simply focusing on the difference between the earnings of high school and college graduates overlooks the fact that the largest gains arrive in big jumps whenever someone has acquired a degree—whether from high school, college, or graduate school—and not incrementally with additional years of education.

Although college grads are often reported to earn 60% more than high school grads, for example, that figure reflects the fact that roughly 10% of college grads pursue postgraduate work. Actually, the study finds that those with four-year degrees earn on average about 52% more, while those with at least two years of graduate school (many of whom attain graduate degrees) enjoy much larger income premiums.

Indeed, the biggest relative income gains over the past 20 years have been racked up by those attaining master's and other postgraduate degrees, with the edge over high school grads widening from 46% in 1973 to 73% in 1993. On the other hand, the average income premium for students completing fewer than four years of college has barely edged up from 15% to 19%.

The bottom line for college students assessing their earnings outlook: Whatever amount of higher education will help, those who actually receive a bachelor's degree can look forward to earning about 28% more on average than their classmates who drop out of college after a year or two—and those who complete postgraduate studies will average at least 45% more. In other words, the more sheepskins you take home, the more golden your financial future is likely to be.

THE PAYOFF FROM GOING TO COLLEGE



AMES C. COOPER & KATHLEEN MADIGAN

HOPPERS HIT A SPEED BUMP, BUT MAY REV UP AGAIN

The foundations for stronger growth are already in place

U.S. ECONOMY

As Washington's data mills start to close the books on the second quarter, the numbers prove only what most economists had expected: Demand, especially by consumers, slowed sharply after the first quarter's surge. Now the attention of the financial markets and business planners is keenly focused on the third quarter. Will it be more of the same, or was the slowdown just a pause before another burst of strength?

Very little third-quarter data are available, but based on second-quarter trends in several key areas, such as retail sales, income growth, financial-market conditions, factory orders, and industrial production, the foundations for a growth rebound are in place. In particular, consumer spending seems set to pick up, perhaps substantially, given that

underpinnings of household demand are even stronger now than they were six months ago. When the Commerce Dept. reports on second-quarter gross domestic product on July 31, the numbers are expected to show that, despite weak consumer savings, capital spending by businesses continued to grow strongly in response to good profits, cheap financing, and robust demand, especially from abroad. Indeed, despite the strong dollar, exports generally are increasing amid improvement in the economies of key foreign markets. And housing is showing resilience in the face of lower mortgage rates and healthy job markets. Still, the retrenchment in consumer spending—which accounts for two-thirds of GDP—means the economy grew by only about 2%.

BUT SURPRISINGLY, retailers bore the brunt of the ongoing consumer slowdown. Retail sales rose a larger-than-expected 0.5% in June, but that followed three consecutive drops (chart). After adjusting for prices, real volume probably fell at an annual rate of 2.5% in the second quarter.

However, not all retailers suffered equally. In particular, sales of motor vehicles and gasoline collapsed last quarter. The former partly reflects a recoil after car sales surged 16.3% in the first quarter, largely because of one-time factors, such as early tax refunds and un-

usually good weather. The latter drop in receipts represents the fall in energy prices. As the consumer price data show, gas prices plunged at a 26.6% annual rate last quarter. Cheaper energy has contributed to the slowdown in overall inflation (chart). As a result, households have greater buying power—a big reason why shoppers can bounce back.

Sales elsewhere strengthened as the quarter progressed. Furniture stores and building-material retailers posted healthy sales gains last quarter on top of solid advances in the first. Those increases reflect the strong housing market, and the trends in the latest survey of homebuilders and in mortgage applications for home purchases suggest that home buying will remain at a high level in the second half. Through the week ended July 4, the four-week average of applications was the highest since the Mortgage Bankers Association of America started keeping track in 1990.

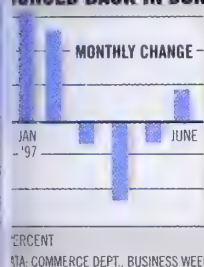
Other retailers, including department stores and food and apparel sellers, saw small declines in sales last quarter. Again, however, the weakness occurred early in the quarter, so that these merchants headed into the third quarter with some selling momentum. Department-store sales increased a solid 0.9% in June after rising 0.5% in May.

For early July, at least, retail survey results are mixed. But more important, no data released in the second quarter show any changes in the health of consumer fundamentals. Job and income growth remained solid, while consumer confidence jumped. The soaring stock and bond markets are adding to household wealth, while hopes of a tax cut are contributing to a sense of well-being. Moreover, the fiscal 1998 budget, which kicks in on Oct. 1, is likely to be stimulative, with any pain from deficit-cutting reserved for later years.

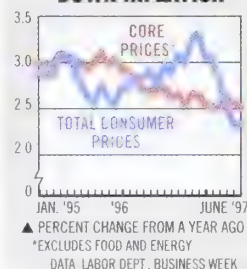
THE LATEST DATA ON PRODUCTION also show evidence of momentum heading into the third quarter. Not only were manufacturers busy at the end of the second quarter, but the latest readings on orders and inventories argue that output will continue to expand.

Industrial output rose 0.3% in June, led by gains in transportation equipment and utility output. Factory

RETAIL SALES PLUNGED BACK IN JUNE



ENERGY HAS BROUGHT DOWN INFLATION



output alone was also up 0.3%. For the quarter, industrial output grew at a 4.2% annual rate, not far below the 4.5% pace of both the fourth and first quarters.

Production of business equipment, particularly high-tech machinery, is leading the advance (chart). Production of information-processing equipment—everything from grocery-store scanners to office computer networks—soared by about 12% in the first and second quarters (chart). The high-tech production surge reflects both capital investment by productivity-seeking U.S. corporations and the steady double-digit growth of high-tech exports.

Factory output will rise further because the high level of orders show that demand is mounting. New orders excluding aircraft have grown for five consecutive quarters, and the backlog of unfilled orders outside of planes also is rising.

Moreover, businesses cannot fill those orders from their warehouses. Total inventories held by factories, wholesalers, and retailers rose just 0.2% in May. And the inventory-sales ratio, though up a bit from February, was still extremely low by historical standards.

AT THE SAME TIME, the growth in output has not yet put strains on capacity use or raised worries about price pressures. The average operating rate for all industry remained at 83.5% in June. Factory usage slipped to 82.5% from 82.6% in May. But output has

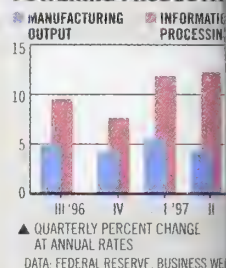
grown faster than new capacity. As a result, operating rates are a percentage point higher than in early 1996.

Even so, the higher operating rates are not in the danger zone typically associated with production bottlenecks and shortages that lead to price increases. Producer prices of finished goods fell for the sixth consecutive month, slipping 0.1% in June. Falling energy prices more than offset a rise in food prices. Excluding volatile food and fuel costs, core producer prices rose just 0.1%. Both the total producer price index and the core index are about flat from a year ago.

Consumer prices are equally tame. The total consumer price index and the core CPI each increased just 0.1% in June. For the entire first half, total prices grew at an annual rate of just 1.4%. Core prices were up 2.4%.

Inflation should remain low in the second half. But investors and executives will more likely concentrate on demand. Capital spending and exports will certainly play roles, but consumers, who account for the bulk of spending, will be squarely in the spotlight. How strongly they snap back will decide just how spunky the third quarter will be.

HIGH TECH IS POWERING PRODUCTION



CANADA

SUNNY SKIES COULD LAST INTO 1998

Like the U.S., Canada should enjoy a second-half blend of solid economic growth and low inflation. Canada, however, has more excess labor and capital, which could keep the combination going longer into 1998.

The economy's strength was clear in the June labor report. The jobless rate fell from May's 9.5% to 9.1%, the lowest in two years. And payrolls increased by 51,500. Job growth last quarter averaged 48,700 a month—the biggest quarterly pace in nearly a decade (chart).

Factory jobs, which accounted for most of the June gain, are at their highest level in 7½ years. That reflects a pickup in manufac-

turing. May factory orders fell only 0.2% after April orders jumped 4.9%. Orders so far in the second quarter stand well above the first-quarter level. With inventories lean, increased orders will have to be satisfied by production gains.

And demand increases are widespread. Exports in the first quarter surged at a 23.2% annual rate, while domestic final sales rose 6.4%. Foreign demand is being lifted by a weak Canadian dollar,

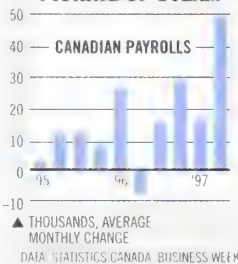
which fell 3.5% against the U.S. dollar in the first half. The Bank of Canada moved to reverse that slide on June 26, when it hiked its overnight lending rate by a quarter-point. Since then, the Canadi-

an dollar has risen 1.4%. Even so Canadian monetary policy is extremely stimulative; short-term rates are nearly two percentage points below U.S. levels.

Canada's real gross domestic product grew at a healthy annual rate of 3.4% in the first quarter, and some economists think it can grow as fast as 4% for all of 1997. Meanwhile, consumer inflation remains at the low end of the Bank of Canada's target of 1% to 3%.

The BOC is likely to hike rates again this fall before inflation rekindles. Policymakers at least have the luxury of some slack in Canada's economy. The BOC said a gap of 2.5% existed between actual and potential GDP at the end of 1996. To be sure, that gap could close quickly if growth soars. But for now, output constraints are more likely to be a 1998 problem.

JOB GROWTH IS PICKING UP STEAM



Shown with available equipment. *J.D. Power and Associates 1999 Automotive Performance, Execution and Layout (APEAL) Study. Study based on a total of 12,000 owner responses. **Excludes other GM divisions. Always wear safety belts, even with air bags. ©1999 General Motors Corporation. All rights reserved. GM, GMC, Yukon and the GMC logo are registered trademarks of General Motors Corporation. Buckle Up, America.



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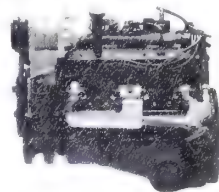


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HOW DEEP IS THE

Losses enrage BT
and reveal the
weakness at
MCI's core

It was a bombshell, all right. At a July 9 board meeting, just 24 hours before disclosing the news to Wall Street, MCI Communications Corp. informed would-be merger partner British Telecommunications PLC, that its fledgling local-service business is on track to lose \$800 million this year—twice what had been predicted. Stunned and humiliated, BT CEO Peter L. Bonfield called an emergency board meeting to review the company's pending \$20 billion-plus deal with MCI. By the time they met on July 11, MCI's stock had fallen 17.4% and BT's 6.4% on the news.

Small wonder BT and MCI brass were under the gun during a contentious three-hour BT shareholders' meeting on July 16 in Edinburgh. Some angry investors opposed the reelection of MCI Chairman Bert C. Roberts Jr. and CEO Gerald H. Taylor to BT's board and pushed for a renegotiation of the merger. One called for Bonfield's resignation.

SILENCE. What didn't happen at the meeting was equally important: BT did not affirm the deal would go forward, and it did not say it would try to renegotiate the terms. BT also did not make a statement supporting MCI brass—a move that would have squelched reports that BT would demand some MCI heads, perhaps including that of President Timothy F. Price.



Industry observers and former BT executives still expect the deal to proceed. But the combination, once hailed as a strategic masterstroke, is now facing setbacks that threaten the combination's emergence as a transatlantic powerhouse in global communications.

Behind all the drama is a simple fact. MCI is not only far from delivering to BT the local connections to American customers it wants; it is also beset by troubles in other businesses, including market share losses in its core long-distance business.

MCI management is trying to keep the attention of BT—and other investors—on its woes in local calling. It accuses the Baby Bells of throwing up blockades against potential competition.

and on July 15, MCI's President called on the Federal Communications Commission to craft new rules to force the Bells to open their markets. The FCC, meanwhile, has announced plans for a task force to look into local competition.

But industry analysts say the few of MCI's woes can be traced to the FCC or even to the Baby Bells. For instance, while MCI complains it is unable to reach agreements to share service with the Bell competing carriers such as GTE are doing just that. "It's convenient to scapegoat both the Bells and the regulators rather than admit that they're in a rotten strategic pickle," says

Scott C. Cleland, an analyst at Legg Mason Wood

Walker Inc.

The gist of MCI's strategic problem: It has not successfully diversified beyond

ROUBLE AT MCI?

distance. In addition to a disappointing start in local calling, it has a glib presence in wireless calling. Investments in Rupert Murdoch's News Corp. and a News Corp. satellite enterprise have yielded little. A consumer service cooked up with Murdoch, and few shoppers flocked to the now defunct online shopping mall. MCI boasts the world's fastest Internet phone but derives just \$200 million a year from Net service sales.

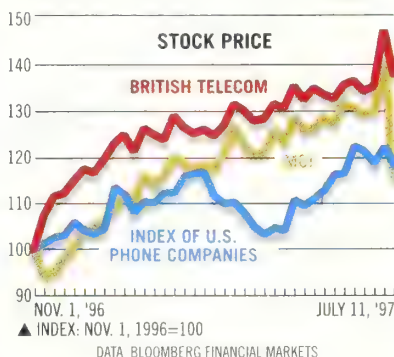
Some analysts chalk this record up to a culture, which evolved around footed marketing campaigns. "In no doubt, MCI acts," explains John Kopppman, a senior analyst at Northern Business Information. "With the emphasis on planning, as the market gets more complicated, it faces problems with the start-and-stop approach."

Now, MCI is slipping in its core long-distance business, which last year accounted for 91% of revenue and virtually all profits. In the first quarter, MCI's long-distance traffic grew just 4%, while AT&T's grew at 14% and WorldCom's grew even faster. MCI's market share is flat at 17.7%. Analysts don't expect local-calling losses to affect second-quarter earnings on July 29—but expect a 30% drop for the year, to \$1.70 a share.

Like its archrival, AT&T, MCI is being maneuvered by smaller companies such as WorldCom that undercut the guys on price and jump on new technology sooner. WorldCom subsidiary ET Technologies Inc., for example, is attempting to peel off a chunk of long-distance sales by routing faxes over the Internet. Faxes are responsible for 34% of U.S. long-distance traffic, according to Dan Briere, a consultant at Tele-Price. Price says any slowdown in long-distance is temporary and MCI is gaining among high-margin business customers.

If he's wrong, there's nothing to fall back on for earnings. MCI has, for example, all but dealt itself out of wireless, the fastest-growing voice phone market. Instead of creating its own wireless

INVESTORS FOCUS...



...ON MCI'S WOES

LOCAL PHONE BUSINESS MCI faces \$800 million in losses this year—twice the level anticipated—and it will likely incur up to \$1 billion in losses in 1998.

LONG-DISTANCE SERVICE MCI saw calling growth drop to a market-lagging 4% in the first quarter. New entrants are pushing down prices and putting pressure on market share of MCI and AT&T.

WIRELESS PHONE SERVICE Unlike rivals AT&T and Sprint, MCI chose not to build a wireless network. Instead, it is buying capacity from NextWave Telecom, a company now facing financial woes.

SATELLITE VENTURES MCI's \$682 million investment in a satellite slot for Rupert Murdoch's direct-broadcast satellite venture has yet to pay off.

network, the company resells calling capacity from competitors such as AT&T and Bell Atlantic Corp. and Nynex Corp. Then there is personal communications service (PCS). Three years ago, MCI sat out the government auctions of spectrum to offer PCS, even though Sprint and AT&T were snapping up licenses for national coverage. MCI's plan was to resell service from NextWave Telecom Inc. But NextWave is struggling to pay off its \$4.9 billion auction bid. Meanwhile, MCI's competitors are already launching PCS service.

MCI's investments in direct-broadcast satellites have also yielded little. Since 1995, MCI has invested \$1.3 billion in News Corp. and paid \$682 million separately for a satellite slot for a subscription service with News Corp. So far, no payoff. "It's premature to fully evaluate this business," says an MCI spokesman.

MCI still offers British Telecom a prominent place in the vast U.S. market, and its heavy investment in local service could eventually pan out. "I still believe the long-term benefits [of pushing into local calling] are going to be worth it," says Bonfield.

But the way MCI disclosed its latest problems to BT has created deep tensions between the companies. And there are signs of disagreements to come over the future of MCI's local-market strategy. BT Finance Director Robert Brace won't comment on whether MCI has agreed to put its plans on hold while BT conducts its review.

Perhaps the most lasting impact of the MCI-BT family crisis may be the strained relationship between the two companies' managers. Bonfield is unlikely to resign, and MCI's Roberts and Taylor will likely be voted back onto BT's board. But MCI's thunderbolt means that at the very least, the honeymoon between MCI and BT is over before anyone has said "I do."

By Catherine Yang in Washington, Julia Flynn in Edinburgh, Peter Elstrom in New York, and Amy Barrett in Philadelphia



CORPORATE PROFITS

LESS GUSTO THIS TIME AROUND

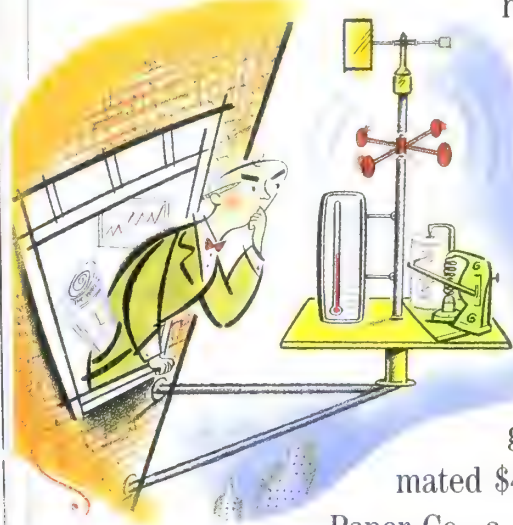
Despite some standouts, the second quarter wasn't superb

Will the second quarter keep up the pace of 30% earnings growth of 1997's first three months? So far, the answer appears to be no. That's the signal from the 80 companies in *BUSINESS WEEK*'s flash report on second-quarter profits, which rose 8%, while sales were up 7%. What

happened? Despite standout reports from Intel, Ford, and General Electric, other companies brought down the average with disappointing returns and write-downs. Chrysler Corp.'s earnings fell 53%, because an en-

gine-plant strike cost an estimated \$438 million. At International Paper Co., a \$419 million loss included

\$535 million in pretax charges. There was good news in tech stocks (see below). But overall, investors will have to wait a while longer for another profit blowout.



COMPUTERS

RIDIN' THAT TECH TRAIN

Strong PC sales and big earnings buoy investors

All year long, as the bull market gathered a new head of steam and pushed through previous records, investors kept a careful eye on the technology stocks that have been such a huge factor in the market's rise. For

months, any sign of trouble—real or imagined—sent tremors through the tech sector. By the end of the first half, the Standard & Poor's Computer Systems Index trailed the S&P 500 stock index by 2%.

Not anymore. As analysts began to focus on second-quarter earnings, it became clear that the boom in personal-computer sales—the key driver of the tech sector—was not slowing. Investors launched a tech-stock buying spree and drove tech-laden market indexes to new highs. For the first two weeks of July, the S&P computer index soared 15%, vs. a 4% gain in the broader S&P 500 index. Instead of getting the jitters, investors

viewed news through rose-colored glasses. Analysts took a round of price cuts by Compaq, Hewlett-Packard, and IBM not as a sign of a margin-eroding price war but as a harbinger of greater sales and smooth sailing through the Christmas selling season.

More broadly, the technology sector is still delivering the best earnings growth in the galaxy. According to data compiled by FirstCall Corp., analysts expect a 27% jump in profits from tech companies in the second quarter of 1997, up from 28% for the year. Tech's June-quarter earnings jump, says FirstCall, should be more than double the next-highest sector, consumer noncyclicals. "Techni-

CURRENT QTR. SALE
(MILLIONS)

INDUSTRIALS

ABBOTT LABORATORIES	2,900.4
ALCOA	3,432.0
BLACK & DECKER	1,182.2
BOISE CASCADE	1,333.0
CHRYSLER	14,388.0
CINCINNATI MILACRON	452.1
COCA-COLA ENTERPRISES	2,905.0
CONAGRA	5,795.3
CORNING	1,031.1
CPC INTERNATIONAL	2,104.5
CROWN CORK & SEAL	2,286.6
CUMMINS ENGINE	1,396.0
EASTMAN KODAK	3,853.0
FORD MOTOR	40,265.0
GENERAL DYNAMICS	1,032.0
GENERAL ELECTRIC	21,997.0
GENERAL MOTORS	45,146.0
GEORGIA-PACIFIC	3,326.0
HARLEY-DAVIDSON	444.1
INLAND STEEL INDUSTRIES	1,321.2
INTERNATIONAL PAPER	5,000.0
JOHNSON & JOHNSON	5,698.0
NIKE	2,373.9
NORTHROP GRUMMAN	2,087.0
PFIZER	2,913.0
PHELPS DODGE	1,065.0
REYNOLDS METALS	1,783.0
TEMPLE-INLAND	907.9
TEXTRON	2,667.0
TRW	2,852.1
WEYERHAEUSER	2,909.0
WHIRLPOOL	2,117.0

SERVICES

AMR	4,710.0
BANKAMERICA	NA
BARNETT BANKS	NA
BOISE CASCADE OFFICE PRODUCTS	600.5
CALIBER SYSTEM	574.7
CHASE MANHATTAN	NA
CITICORP	NA
DOW JONES	640.7
ENRON	3,240.0
FEDERAL EXPRESS	3,068.3

CHG.	EST. EPS (5/15)	REPORTED EPS	DIFF.		CURRENT QTR. SALES (MILLIONS)	% CHG.	QTR. PROFITS (MILLIONS)	% CHG.	EST. EPS (5/15)	REPORTED EPS	DIFF.
+5	0.87	0.94	+0.07	FIRST CHICAGO NBD	NA	NA	378.0	+5	1.19	1.20	+0.01
+11	0.68	0.68	—	FOOD LION	2,324.7	+12	49.7	+2	0.11	0.11	—
-57	1.16	1.19	+0.03	GRAINGER (W.W.)	1,051.2	+18	57.6	+16	1.06	1.13	+0.07
0	0.46	0.47	+0.01	HERTZ	976.3	+7	53.9	+36	0.43	0.50	+0.07
NM	-0.49	-0.53	-0.04	KROGER	6,231.8	+7	108.1	+38	0.40	0.41	+0.01
-53	1.30	1.33*	+0.03	MARRIOTT INTERNATIONAL	2,878.0	+22	83.0	-11	0.61	0.61	—
-24	0.43	0.45	+0.02	McGRAW-HILL	836.7	+18	65.2	+14	0.60	0.65	+0.05
-88	0.25	0.29	+0.04	MERRILL LYNCH	8,011.0	+29	481.0	-11	0.91	1.24	+0.33
NM	0.80	0.81	+0.01	MORGAN STANLEY, DEAN WITTER	3,517.0	+12	527.0	-7	0.84	0.50	-0.34
-35	0.44	0.56	+0.12	MORGAN (J.P.)	NA	NA	374.0	-15	1.94	1.85	-0.09
NM	1.11	1.04*	-0.07	NATIONSBANK	NA	NA	762.0	+26	1.00	1.02	+0.02
-27	1.05	0.98	-0.07	ROADWAY EXPRESS	609.4	+14	7.8	+92	0.42	0.38	-0.04
-20	1.22	1.39	+0.17	RYERSON TULL	730.0	+20	19.1	+1	0.45	0.49	+0.04
-16	1.38	1.12	-0.26	SAFETY-KLEEN	229.9	+9	13.3	-2	0.22	0.23	+0.01
-33	1.53	2.06	+0.53	SAFEWAY	5,249.2	+33	134.1	+26	0.54	0.54	—
-19	1.19	1.28	+0.09	SALLIE MAE	937.7	+6	119.2	+16	2.05	2.20	+0.15
-13	0.65	0.66	+0.01	TIME WARNER	3,193.0	+49	30.0	NM	-0.15	-0.09	+0.06
0	2.65	2.68	+0.03	TRAVELERS GROUP	5,973.1	+10	662.9	-15	0.92	1.00	+0.08
170	0.24	0.30	+0.06	WELLS FARGO	NA	NA	228.0	-37	3.81	2.49	-1.32
-23	0.63	0.65	+0.02	TECHNOLOGY	36,204.3	+13	3,504.6	+40	0.84	0.77	-0.07
-19	0.59	0.77	+0.18	ADVANCED MICRO DEVICES	594.6	+31	10.0	NM	0.21	0.07	-0.14
NM	0.14	0.20*	+0.06	AMGEN	620.5	+9	200.5	+12	0.71	0.72	+0.01
-15	0.68	0.68	—	APPLE COMPUTER	1,737.0	-20	-56.0	NM	-0.55	-0.44	+0.11
-16	0.71	0.52	-0.19	COMPAQ COMPUTER	5,012.0	+25	214.0	-20	1.38	1.48*	+0.10
-16	1.57	1.72	+0.15	EATON	1,909.0	+7	126.0	+22	1.44	1.64	+0.20
+16	0.36	0.35	-0.01	GENENTECH	233.5	-4	23.8	+10	0.24	0.19	-0.05
+7	1.89	2.16	+0.27	HONEYWELL	1,977.3	+12	98.4	-18	0.77	0.77	—
-8	0.73	0.76	+0.03	HUGHES ELECTRONICS	4,755.7	+17	541.4	+77	0.62	0.55*	-0.07
-56	0.23	0.28	+0.05	INTEL	5,960.0	+29	1,645.0	+58	1.08	0.92	-0.16
-16	0.84	0.85	+0.01	MOTOROLA	7,521.0	+10	268.0	-18	0.58	0.44	-0.14
+15	1.03	1.06	+0.03	RAYTHEON	3,324.7	+6	209.5	0	0.89	0.89	—
+6	0.27	0.47*	+0.02	TEXAS INSTRUMENTS	2,559.0	+7	224.0	+446	0.84	1.07*	+0.23
+25	0.86	0.86	—	UTILITIES & TELECOM	20,028.5	+11	1,791.0	+15	0.65	0.67	+0.02
-1	0.92	0.89	-0.03	AMERITECH	3,986.0	+6	537.0	-5	1.12	1.13*	+0.01
+3	3.31	3.26	-0.05	COLUMBIA GAS SYSTEM	810.7	+39	34.9	+326	0.43	0.63	+0.20
+11	1.04	1.07	+0.03	FPL GROUP	1,587.1	+8	170.1	+9	0.90	0.95	+0.05
+13	0.80	0.80	—	GTE	5,692.0	+8	671.0	+5	0.72	0.70	-0.02
-14	0.23	0.19	-0.04	LUCENT TECHNOLOGIES	6,340.0	+18	213.0	+196	0.25	0.33	+0.08
NM	0.44	0.34	-0.10	PUBLIC SERVICE ENT. GROUP	1,320.0	-1	106.2	-18	0.53	0.39	-0.14
+8	2.06	2.11*	+0.05	TELLABS	292.7	+54	58.8	NM	0.28	0.32	+0.04
+8	2.08	2.10	+0.02								
-33	0.35	0.36	+0.01								
NM	0.49	0.40*	-0.09								
+15	1.06	1.14	+0.08								

† Third-quarter results †† Fourth-quarter results NM = not meaningful NA = not available *EPS adjusted for special items

DATA: STANDARD & POOR'S COMPUSTAT, A DIVISION OF MCGRAW-HILL INC. EARNINGS ESTIMATE DATA PROVIDED BY I/B/E/S INTERNATIONAL INC. NEW YORK, N.Y. I/B/E/S IS A REGISTERED TRADEMARK OF I/B/E/S INTERNATIONAL INC.

is the real standout this quarter, cite all the pre-announcement data," says the firm's research director, Charles L. Hill.

Strong earnings from bellwether computer and semiconductor stocks had investors pouring money into stocks the week of July 15, Intel Corp. reported a better-than-expected 58% jump in second-quarter earnings, to \$1.6 billion on a 29% sales increase, 6 billion. Intel CEO Andy S. Grove, who in May warned of softness in

some Intel chips, said he saw "strong" demand for Intel's newest Pentium chips. The same day, Texas Instruments Inc. streaked 12 points to close at 109%,

a 52-week high, on strength in chips for modems, cell phones, and multimedia PC gear.

The bulls' best friend, however, was Compaq Computer Corp. Its unit sales rose 42%, topping a 27% first-quarter gain. Compaq hit a new high of 133% on July 16, up 79% so far this year. That helped push the S&P computer index to a new 52-week high of 352.8 on July 16.

Compaq's sales surge, company executives disclosed, was the result of a new pricing scheme aimed at halting



inroads by rival Dell Computer Corp. After price cuts of up to 15% on selected models in April and May created fresh demand, the company made across-the-board cuts in July. But earnings won't suffer, the company says, because an overhaul to its manufacturing and distribution system has cut costs. Production plans call for delivering 33% higher unit shipments in the second half of this year.

That's nearly twice the expected industry growth rate—and a sign of trouble ahead for some PC makers. International Data Corp. and Dataquest Inc. are predicting that worldwide PC unit sales will rise by 15.5% and 19%, respectively, this year, vs. 18% in 1996. Outsize gains by Compaq, Dell, IBM, Gateway 2000, and other strong performers come at the expense of other players. "There's no middle ground right now," says CompuUSA Inc. Chief Executive James F. Halpin. "You're either doing well or doing poorly." Agrees Compaq CEO Eckhard Pfeiffer: "The big brand names will continue gaining share."

ROOM TO GROW. That could spell more woes for middle-tier suppliers, such as Apple Computer, AST Research, Acer Group, and Packard Bell NEC—all of which are struggling to halt market-share losses. With their broader product lines and aggressive pricing, the biggest companies are soaking up sales that once went to niche specialists. Home-PC specialist Packard Bell NEC Inc., for instance, is being forced to create a corporate sales effort to offset slowing sales to consumers.

Dell shows the results of this shift. Its share price has jumped 178% this year, to 148%, on July 16—after nearly tripling last year. With just a 6% share of the huge PC market, "Dell can continue to grow at twice the market rate," predicts Southeast Capital Corp. PC analyst Ashok Kumar.

Will the Intels, Dells, and Compaqs lead the tech sector—and the market—to more records? It's good to bear in mind that summer, with its retail slowdown, is the season when the market frets about tech stocks. Last July's 17% drop in the NASDAQ index is still fresh in many investors' minds. But this year, there's no sign of flagging enthusiasm for tech. "Christmas has come every year in the PC industry. I'd be willing to bet money it comes this year," says Michael Carmen, vice-president at Boston money-manager State Street Research & Management Co. For investors, it's looking a little like Christmas in July.

By Gary McWilliams in Houston, with bureau reports

EXECUTIVE SUITE

IS APPLE MINCEMEAT?

Maybe not, if it's willing to embrace dramatic change

Apple Computer Inc. is caught up in a desperate search for a new chief executive. But everywhere in the computer industry, executives agree that what Apple needs most is a radical new survival plan. Everywhere except at Apple, that is. "We don't expect any major changes in our strategy," says Chief Financial Officer Fred D. Anderson Jr., who took on day-to-day CEO duties after Gilbert F. Amelio was ousted on July 9. "We believe the Mac platform is still viable."

Maybe, but interested and disinterested observers, from Apple investor

sage: "Let's consider any alliance that makes sense. I'm willing to listen to anything."

An alliance would be a start. Many experts are urging Apple to finally take the most radical step of all: stop fighting the Intel/Microsoft PC standard. That would mean continuing to make Macs for its loyal legions but building a new business in "Wintel" using Intel Corp. microprocessors and Microsoft Corp.'s Windows software. Apple would compete on its brand name and design expertise. Says McNealy, who came close to buying Apple



"At this point, they need somebody who will just walk in and say 'We're going to be a Compaq'"

*Sun Microsystems
CEO Scott McNealy*



"I propose radical surgery fast. I believe a comeback is still definitely possible"

*—Former Apple CEO
John Sculley*



"Let's consider any alliance that makes sense. I'm willing to listen to anything"

*—Apple investor
Prince Alwaleed*

Prince Alwaleed bin Talal bin Abdulaziz Al Saud to Sun Microsystems Inc. CEO Scott McNealy, are concluding that a dramatic change is necessary to lure a top-flight turnaround expert and give Apple a future. "Let's forget ego. We can't just say 'Apple, Apple, Apple,'" says Alwaleed, who bought a 5% stake earlier this spring for around \$17 a share—only to watch it fall to a 10-year low of \$13 before Amelio's resignation.

On July 13, Prince Alwaleed told BUSINESS WEEK, he fired off an angry one-page letter to Anderson. The mes-

sage: "At this point, they need somebody who will just walk in and say 'We're going to be a Compaq' or we're going to be a [Sun-compatible] player. We're down to Tyson-Holyfield.... I'd better to have your ear chewed on than to be sitting outside the ring."

It's not a pretty choice. But it could give Apple, which has lost \$1.6 billion over the past two years, a shot at a future. For this plan to work, however, experts say Apple would also need to sell off its ailing operating-system software operation, which costs at least

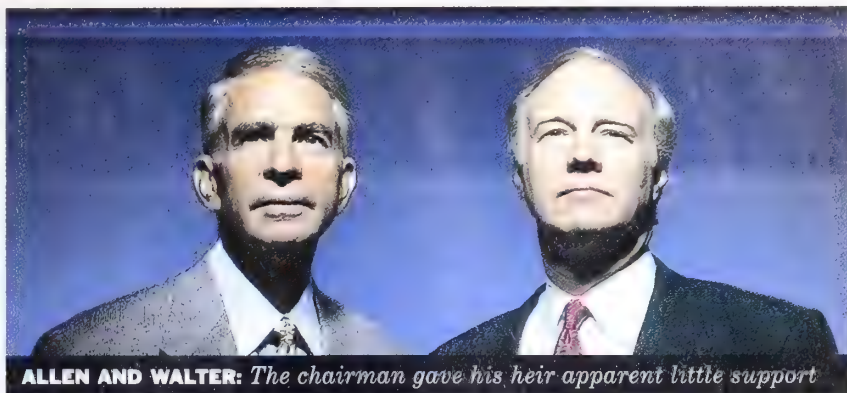
million a year to support. "Apple lost the OS war, and there's no point in repeating it again and again," says David Yoffie, a professor at Harvard business school and a director of Intel. He's not alone in that sentiment. In a survey of nearly all 160 industry bigwigs at a Harvard executive seminar studying the market, 80% voted that it should be broken up. The software piece sold or spun off, according to Yoffie.

That's not necessarily bad news for Apple. It would end the conflict between Apple and makers of Mac clones, which has been luring away Apple's best customers. Selling off software would also allow Apple to focus on its last remaining strength—its world-renowned brand and proprietary hardware design. Yoffie figures Apple could reach a 5% share of the total market—it now has about 3%—and a package-like valuation of \$12.5 billion, more than Apple's \$2 billion today. Moving into the PC camp is just one alternative for the company. Some think Apple should retrench and sell strictly to its free-spending followers in publishing, multimedia, and graphic arts.

TUNNEL. Former Apple CEO John Sculley sees a hybrid track. He thinks Apple should partner with a PC maker to attack the education market, where Apple is fast losing ground, while selling to the digerati. "I propose radical change very fast," he says. "I believe a comeback is still definitely possible." For now, a key player is Apple director and DuPont Chairman Edgar S. Snider Jr. He says consultants will be evaluating the alternatives and the board may be considering some on July 21. He is urging Apple to fill three empty director seats—hopefully with PC-industry executives. The search for a CEO is expected to continue through the summer. Sculley is not on Apple's side. On July 1, the company announced a \$56 million drop in a 23% slip in quarterly sales, to \$1.1 billion. That was better than analysts expected. But ABN AMRO Chicago analyst David Wu looks for a 1997 revenue of \$458 billion on revenues of just \$450 billion, down from \$9.83 billion a year ago.

The stock, now around 15, dips below 10, Apple may not have a chance to succeed with any of these strategies. An investor group including Microsoft director and venture capitalist David F. Marquardt would consider a run at Apple if the stock falls into single digits, according to an individual close to the group. Anon says Apple plans to remain independent but has a fiduciary duty to evaluate any reasonable proposal. How about a reasonable strategy proposal?

by Peter Burrows with Robert S. Lippman in San Francisco and John Sant in Rome



ALLEN AND WALTER: The chairman gave his heir apparent little support

COMMENTARY

By Peter Elstrom

AT&T: JOHN WALTER ISN'T THE ONLY ONE WHO SHOULD GO

Enough. It's time for the board of AT&T to find real leadership. For too long, the company has been spinning its wheels under Chairman and Chief Executive Officer Robert E. Allen. It's up to the board to ensure that Allen sticks to his stated plan to step down as CEO next January and as chairman next May.

The forced resignation of John R. Walter is the most telling example of how poorly Allen has been serving the company. Last year, Allen recruited his own successor, choosing a surprise candidate, the CEO of printer R. R. Donnelley & Sons Co. But Allen has been voicing concerns about Walter to other directors, and on July 15, he told the board that he didn't think his man was ready to become CEO in January, according to Walter Y. Elisha, the AT&T director who will lead the new CEO search. Outside directors voted unanimously that Walter shouldn't get the CEO post in January. Walter resigned and said in a press release, "I believe I am perfectly qualified to be CEO of AT&T right now."

LONG-DISTANCE LOSS. What next? Allen had planned to give up the CEO title in January and the chairmanship in May. Now, Vice-Chairman John D. Zeglis will run day-to-day operations while Allen, Elisha says, will stay on as long as the board needs him. "I think this means Allen is firmly in place," says J. Christopher Landes, a consultant at TeleChoice Inc.

Leaving Allen in place would solve none of AT&T's problems and perhaps create new ones. AT&T's leadership in the U.S. telecom industry is already

slipping. It's losing share in long distance and is grasping for a way into the \$100 billion local business. Allen's best idea was to attempt a massive merger with SBC Communications Inc. But federal regulators immediately attacked the idea, and SBC pulled the plug. "It's frightening to see a company this big shooting themselves in the foot over and over," says Jeffrey Kagan of Kagan Telecom Associates.

Who could run AT&T now? In the near term, Zeglis could fill in. He has been leading the company's efforts in local calling, but lacks operational experience. Elisha says when the list of CEO candidates comes out, "John's name will be on it."

The board should aim higher. After all, Zeglis was already passed over twice for the COO job. AT&T needs a dynamic leader with the technical savvy to push the phone giant into new markets. One long-shot possibility: George M. C. Fisher, the chairman and CEO of Eastman Kodak Co. The former CEO of Motorola is already on the AT&T board and has the right résumé. But Kodak is in the middle of a strategic turnaround. Still, AT&T watchers point out that Fisher is one of the few outside directors not on the CEO search committee. "If he's not on the search committee, it's Fisher," says one former AT&T exec.

That may be wishful thinking. But it's time for AT&T directors to wish for something better—for the company and its beleaguered shareholders.

Elstrom is BUSINESS WEEK's telecommunications editor.

COMMENTARY

By James C. Cooper

IN THE NEW ECONOMY, THE OLD RULES STILL LIVE

These are tough times for traditional inflation theory. A soaring U.S. economy, fueled by the forces of globalization and technology, has pushed joblessness down to levels not seen in decades. But consumer inflation remains tame, and producer prices are actually falling. Convinced

that the New Economy can continue along this course, investors have bid the stock market to new highs.

But there's a more classical view of the economy that still should be heeded. Virtually all mainstream economists say it's too early to scrap economic theories that for decades have reliably predicted inflation. Ignoring these basics is especially risky in a high-flying financial climate that is sensitive to Federal Reserve policy decisions.

INFLATION AND JOBS. First, a review of the Econ 101 lectures you may have slept through. The topic: Phillips curve theory and the concept of NAIRU, a clunky acronym for "non-accelerating-inflation rate of unemployment." Together, these relate joblessness and inflation—NAIRU being the jobless rate at which inflation is stable. The Phillips curve/NAIRU model suggests that inflation is caused by excess demand—demand beyond what available workers and machines can satisfy. The excess occurs when the jobless rate dips below NAIRU, causing wages and inflation to accelerate. But the process doesn't end there. Higher inflation reduces demand and labor markets readjust, pushing joblessness back to the NAIRU level. But the inflation persists at the higher level, partly because people adjust to it.

Despite the current, unusual situation of low unemployment and low inflation, the old model is alive and well among economists—and at the Fed. "I am a strong and unapologetic



INFLATION GAUGE: Tame prices are boosting investor confidence

proponent of the Phillips curve and the NAIRU concept," says Federal Reserve Governor Laurence H. Meyer. Chairman Alan Greenspan, warning to the New Economy, is less enamored. But he appreciates the model's solid track record.

The Phillips/NAIRU model has practical limitations. But understanding those limits doesn't mean junking the theory. The model can still work, but it's crucial to peg the level of NAIRU—a moving target. Before globalization and technology pushed

PHILLIPS CURVE AHEAD

A classic inflation model still applies in the New Economy

MOVING TARGET The link between unemployment and inflation remains. But the level at which dropping unemployment triggers inflation may be lower than it has been in the past.

JUST WAIT Inflation seems dead now. But it can take a long time, a year or more, for lower unemployment levels to translate into faster inflation.

GOOD LUCK Huge investments in technology are netting productivity increases and extending the economic cycle. But the U.S. economy is also enjoying some temporary windfalls, ranging from falling oil prices to slower growth in benefit costs.

NAIRU below 6% a few years ago, the model had a two-decade run as one of forecasters' best performing tools. Now NAIRU may be even lower than the generally accepted range of 5½% to 5¾%.

It can take a year or more for inflation to pick up after a gap opens between the unemployment rate and

NAIRU. That's why the Fed's experiment to test the economy's inflationary limit is dangerous. The wider the gap, the more inflation will rise—and it will not fall until the jobless rate exceeds NAIRU. That is, until the Fed steps in to clamp down on the economy, thus throwing a lot of people out of work.

ECONOMIC WINDFALLS. Another consideration: The Phillips/NAIRU model cannot reflect good economic luck, and this U.S. business cycle has had more than its share: falling oil prices, a stronger dollar, and weaker growth among overseas competitors. Also, a slowdown in benefit expenditures has curbed labor costs, even as wage growth has picked up—as the model predicts.

Right now, the model does not forecast any strong pickup in inflation. But for every half point the jobless rate stays below NAIRU for a year, inflation will accelerate by a quarter point. And a stronger second half could send the unemployment rate even lower.

That's great—if you're seeking employment. But traditional inflation theory says that, if the Fed's current gamble with tight job markets fails, the costs of excess demand now will be foregone output and income later on. Even in the New Economy, the old approach to gauging future inflation should scarcely be ignored—it should be embraced.

Cooper is BUSINESS WEEK's senior economist.



HIGH-POWERED BACKERS:
Hillary Clinton and Rubin

facing for months. But now it appears that the Clintons' ties to several grant recipients are more extensive than previously known. Furthermore, four of the CDFIs are so closely linked to one another that Bachus and other critics say that Treasury may have violated a \$5 million-per-institution limit on CDFI grants. And the House probe has uncovered evidence that Treasury officials prepared misleading documents after the fact to support funding decisions.

A White House spokesman says that neither the President nor Mrs. Clinton had any contact with the Treasury officials overseeing

the CDFI program. But Bachus charges CDFI officials with "a calculated effort to mislead Congress." Rubin, in a July 15 letter to lawmakers, says Treasury is taking steps to correct problems in the CDFI program, but he is convinced that award decisions were based "solely on merit."

TANGLED WEB. Community development banks, which exist in almost every state, started with Chicago's Shorebank Corp. It was founded in 1973 to lend money for housing rehabilitation on Chicago's South Side. In 1986, the Clintons helped create Arkansas' Southern Development Bancorporation. Shorebank Senior Vice-President Jan Piercy, a college roommate of Hillary Clinton, helped establish Southern Development. Piercy is no longer at Shorebank. But the Clintons maintain ties to several Shorebank officers and directors, who also have ties to three other CDFIs that got federal funds. In addition, the Clintons have numerous links to a fifth bank that also received a grant. All told, \$13

NDALS

ANKING ON CLINTON CONNECTIONS?

re's suspicion that's just what some community banks did

uring Bill Clinton's 1992 Presidential campaign, he and his wife, Hillary, promised to create dozens of community banks to lend to small businesses in economically deprived areas. Now, 31 entities are about to divvy up \$7 million in federal funds for Community Development Financial Institutions. The CDFI fund, now also a pet project of Treasury Secretary Robert Rubin, is the only Treasury program scheduled for a funding increase next year. Clinton wants CDFI to have a \$1 billion annual budget by the year 2000. Not so fast. Republicans on Capitol Hill are out to get CDFI. After a six-

month probe, Representative Spencer T. Bachus III (R-Ala.), chairman of a House Banking subcommittee, says there's reason to believe its first round of funds were awarded not on merit but on the basis of political favoritism—namely connections to the Clintons. Now, Clinton and Rubin are suddenly scrambling to protect CDFI funds for the fiscal year beginning in October. On July 15, a Senate appropriations panel deleted the \$125 million Congress had budgeted. Bachus and other House Republicans also want to trim the CDFI fund.

Allegations of links between the Clintons and CDFI grantees have been sur-

WFULLY CHUMMY

Of 268 institutions seeking \$17 million in federal development-bank funds, 11% with ties to Bill and Hillary Clinton will receive one-third. They are:

SHOREBANK CORP., Chicago, Ill. It was often cited by Clinton during the '92 campaign as a model community development bank. A college roommate of Hillary Clinton is a former senior vice-president.

SOUTHERN DEVELOPMENT BANCORPORATION, Arkadelphia, Ark. Hillary Clinton was an early board member and served on Southern's board until 1992. Her law firm was Southern's main outside counsel.

LOUISVILLE BANCORPORATION, Kansas City, Kan. and Louisville Development Bancorporation Inc., Louisville,

Ky. Part of a system of banks with ties to Shorebank, which helped prepare their applications. Memos supporting Treasury's July, 1996, awards to Shorebank, Douglass, Louisville, and Southern appeared in files in April, 1997, on the eve of a congressional review.

ENTERPRISE CORPORATION OF THE DELTA, Jackson, Miss. Both Bill and Hillary Clinton helped set up Enterprise's parent, Foundation of the Mid South, in 1992. Hillary was a director of Mid South. President Clinton forwarded a letter to Treasury Secretary Robert Rubin describing Enterprise's success.

million, or more than one-third of the \$37 million awarded so far, went to these five.

Bachus is looking at those connections and at a curious paper trail. When the House investigators looked into Treasury files on the CDFI program in April, there were no memos evaluating the merits of awards to four of the five Clinton-connected institutions—Shorebank and its three progeny—which got \$11 million. Two weeks later, however, aides found undated evaluation memos justifying the grants. According to a letter from House Banking Committee members, the memos were written by Steve Rohde, deputy director of the CDFI Fund.

Treasury Inspector General Valerie Lau, in an unflattering July 11 report to Congress that was quoted in the lawmakers' letter, says Treasury staff worked through the night prior to the second visit to prepare the memos and ignored legal advice to date them. A Treasury spokesman says the undated memos were not meant to mislead, and that funding decisions were based on a rigorous review.

CRONYISM AT WORK. But House Republicans see cronyism at work. Take Jackson (Miss.)-based Enterprise Corporation of the Delta, which received \$2 million from Treasury. Enterprise is a subsidiary of the Foundation of the Mid South, on whose board Hillary Clinton once sat. George Surgeon, until recently an Enterprise board member, also was president of Southern Development, a bank on whose board Mrs. Clinton had served. Surgeon could not be reached for comment.

Enterprise's application was deemed "risky" by a Treasury aide, but recommended for further funding. The grant surprised other applicants who were rejected because they were start-ups. Enterprise's CEO, William J. Bynum, says charges of favoritism are "completely unfounded."

Meanwhile, House staffers are looking into whether Treasury violated the \$5 million cap. One focus: Chicago's Shorebank, which helped prepare the applications of Douglass Bancorporation and Louisville Development Bancorporation Inc. It also gets a portion of Douglass' CDFI award as well as those of several other banks to which it consulted. Some lawmakers believe the institutions are legally tied. A Treasury spokesman says that unless Shorebank owns 25% of the others' stock, which it does not, the funding cap is not breached. Technically true, but Republicans are out to prove a public trust has been breached.

By Paula Dwyer in Washington

MARKETING

A COZY DEAL AT BENETTON?

Publicly owned Benetton buys the family's sports outfit

The four Benetton siblings personify family entrepreneurship, Italian-style. In less than 20 years, they have turned a small wool-dyeing operation into the Benetton Group, one of the world's premier clothing brands. With more than 7,000 outlets in 120 countries



SPORTS MUSCLE

Benetton plans to power its equipment sales with its massive distribution system for apparel

and \$1.8 billion in sales, Benetton has brought riches to its founding family and has become the emblem of northeastern Italy's rebirth as one of the wealthiest corners of Europe.

On July 15, however, the Benettons struck a deal that, some observers say, may take family entrepreneurship too far. The publicly traded Benetton Group, in which the family has a 72% stake and which controls the core clothing business, announced plans to pay \$330 million in cash for Benetton Sportsystem, a grab bag of sports equipment outfits including such well-known names as Rollerblade, Prince tennis rackets, and Nordica ski

boots. All are strong brands, and the deal will increase Benetton Group sales by 50% in one fell swoop.

The problem is, the seller is none other than the Benetton family itself. That has some Italian bankers wondering if the transaction isn't designed mainly to reduce debt at the family's Edizione holding company—the seller of Sportsystem. "The deal boils down to using Benetton Group cash to cover the debt upstairs," says one Milan-based investment banker. In recent years, Edizione has jumped into supermarkets, real estate, fast food, and venture capital, leaving the holding company highly leveraged.

SAVVY OR SELF-SERVING? On the other hand, debt-free Benetton Group, which earned \$145 million last year, is awash in cash. The stock market seems to think Benetton could have done something better with it: The company's American quarterly receipts fell 6.2% to \$30.25.

But Luciano Benetton, the oldest brother and chairman of the group, says the sale makes perfect sense. He says the buyout is at a fair price, and the proposed deal has received a fairness opinion from four investment banks: Milan-based IMI SIGECO, Salomon Brothers, SBC Warburg, and Morgan Stanley.

Moreover, says Benetton, the deal will pay off because of synergies between apparel and sports equipment. "You tap Benetton's power, its extremely efficient sourcing and distribution, and its knowledge of world markets, and you apply that to brands like Nordica, and you can develop a sports clothing brand as well as a sports brand," says Keith Wills, retail analyst at Goldman, Sachs & Co. in London.

The Benettons are already experimenting with merchandising ski boots and clothes together. At the flagship Manhattan store, apparel is on the main floor and sports equipment upstairs. In Europe, the group is planning to launch Playlife stores to sell sports equipment and sports clothing.

So, is the deal a powerful marketing move or an asset shuffle? It's too early to say. If the Benettons boost shareholder value with the deal, the stock market will applaud. But they could have something to explain to do if they can't make sports and clothing into a comfortable fit.

By John Rossant in Rome, with Leo Bongiorno in New York

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'93	2.0	10.6	160
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SPORTS BUSINESS

GREAT PITCHER? MAYBE. GREAT MARKETING? FOR SURE

The buildup for Yankee flamethrower Iribu is phenomenal



BIG DRAW: The new boy is selling tickets

Love George Steinbrenner or loathe him, you've got to say this for the New York Yankees' principal owner: He knows hype. Hideki Iribu's ultimate value to the Yankees will depend on how well the Japanese hurler performs on the

field. But Iribu already has generated such extraordinary fan and media interest that Steinbrenner's decision to sign an unproven, out-of-shape foreign import to a \$12.8 million contract looks shrewder with every passing day.

"Iribu has come into baseball with a bigger buildup than anyone I can remember," says Steven V. Raab, director of special markets for Starter Sportswear Inc., which is selling Iribu T-shirts as fast as it can make them. That includes Hideo Nomo—the Japanese pitcher who became an international star and merchandising gold mine after joining the Los Angeles Dodgers in 1995. "The marketing opportunities that we see with Iribu are tremendous," says Derek Schiller, the team's vice-president for business development.

THROWING SMOKE. Nomo had the advantage of novelty, being the first Japanese to pitch in the major leagues since the mid-1960s. And both he and Iribu enjoy the glamour of being strike-out pitchers. But where Nomo, 28, relies on his guile and a wicked curveball, Iribu, also 28, is a flamethrower in the classically American, crowd-pleasing mold of a Roger Clemens. And the fact that Iribu is pitching for the most fabled franchise in professional sports "is the No. 1 reason there's more hype around him," says Faust E. Capobianco IV, director of licensing for Majestic Athletic Wear Ltd.

Another difference: Nomo only began attracting outside notice after he actually took the mound in Los Angeles. Iribu arrived in New York atop a tsunami of transpacific controversy. His team in Japan had an agreement with



ALL IN A DAY'S WORK

Iribu's hot July 10 debut

YANKEE STADIUM TAKE

30,000 extra tickets sold at an average of \$15 a ticket	\$450,000
Extra food and drink sales (at average of \$10 per)	300,000
Iribu T-shirt sales	80,000
Total	\$830,000

TV TAKE

New York area	19% share (752,000 households)
Japan	17.2% share (6 million households)*

PERSONAL TAKE

Iribu's \$3 million salary for half a season breaks down to \$200,000 per start. Massive endorsement deals should also follow.

*For a 50-minute edited version of game coverage aired at 3:10 p. m. The program was rebroadcast at 12:30 a. m. and drew a 16.1% share. These figures do not include NHK's live satellite broadcast, available to 10 million viewers.

DATA: NEW YORK YANKEES, WPXI, NHK

the San Diego Padres that gave the Padres U.S. rights to the pitcher. It scandalized Japanese fans by refusing to sign with the Padres and threatening to sit out the 1997 season unless he was allowed to negotiate with the Yankees.

Once Iribu got his way, Steinbrenner rose to the promotional occasion, lauded Iribu's pursuit of Yankee stripes as an act of valor: "This young man said, 'I only want to pitch in New York.' He stood up to a whole nation." On May 30, Iribu signed a four-year pact that ranks as the richest contract ever given a player without so much as an inning of professional baseball experience in America.

"The Orient Express," as the New York tabloids dubbed him, got a fat \$8.5 million signing bonus payable over three years and an annual salary starting at \$200,000 and rising to \$2 million in 2001. (Nomo had signed for a \$2 million bonus in the major league minimum salary of \$109,000.) While the 240-pound Iribu was pitching himself into shape in the minors, highlights of his every start were broadcast not only on local New York stations but also on ESPN and other national cable networks.

FULL COUCHES. In his July 10 major league debut, Iribu lived up to the hype before a near-sellout crowd of 51,900, exceeding the usual draw by perhaps 30,000. The added gate and concession stand revenue amounted to nearly a third of the \$3 million the Yankees owe Iribu for 1997 (table). The game also attracted a huge television audience in New York City and Japan, where the broadcast was carried by NHK, the Japanese equivalent of the BBC. Wholesale sales of Iribu T-shirts and warm-up jackets are concentrated in these sports markets, suppliers also report strong orders from Hawaii and mainland U.S. cities with large Japanese-American populations, notably Los Angeles and Seattle.

If Iribu-mania is to endure, the Japanese pitching sensation will have to show that his talent matches his celebrity. "Nomo-mania" steadily grew through 1995 and 1996 on the strength of Nomo's consistently superb pitching. On July 15, Iribu turned in a mediocre second start. Nonetheless, NHK will give Iribu every chance to eclipse Nomo. Its officials have decided that if Iribu and Nomo happen to be pitching simultaneously, the network will show Iribu and the Yankees live and relegate Nomo to tape-delayed broadcast.

By Anthony Bianco in New York

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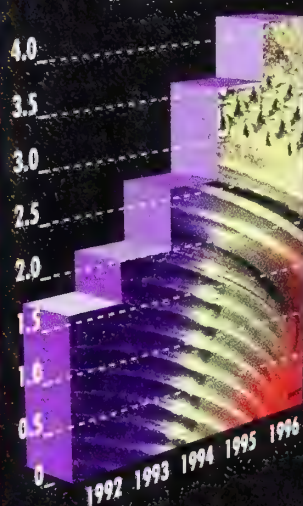
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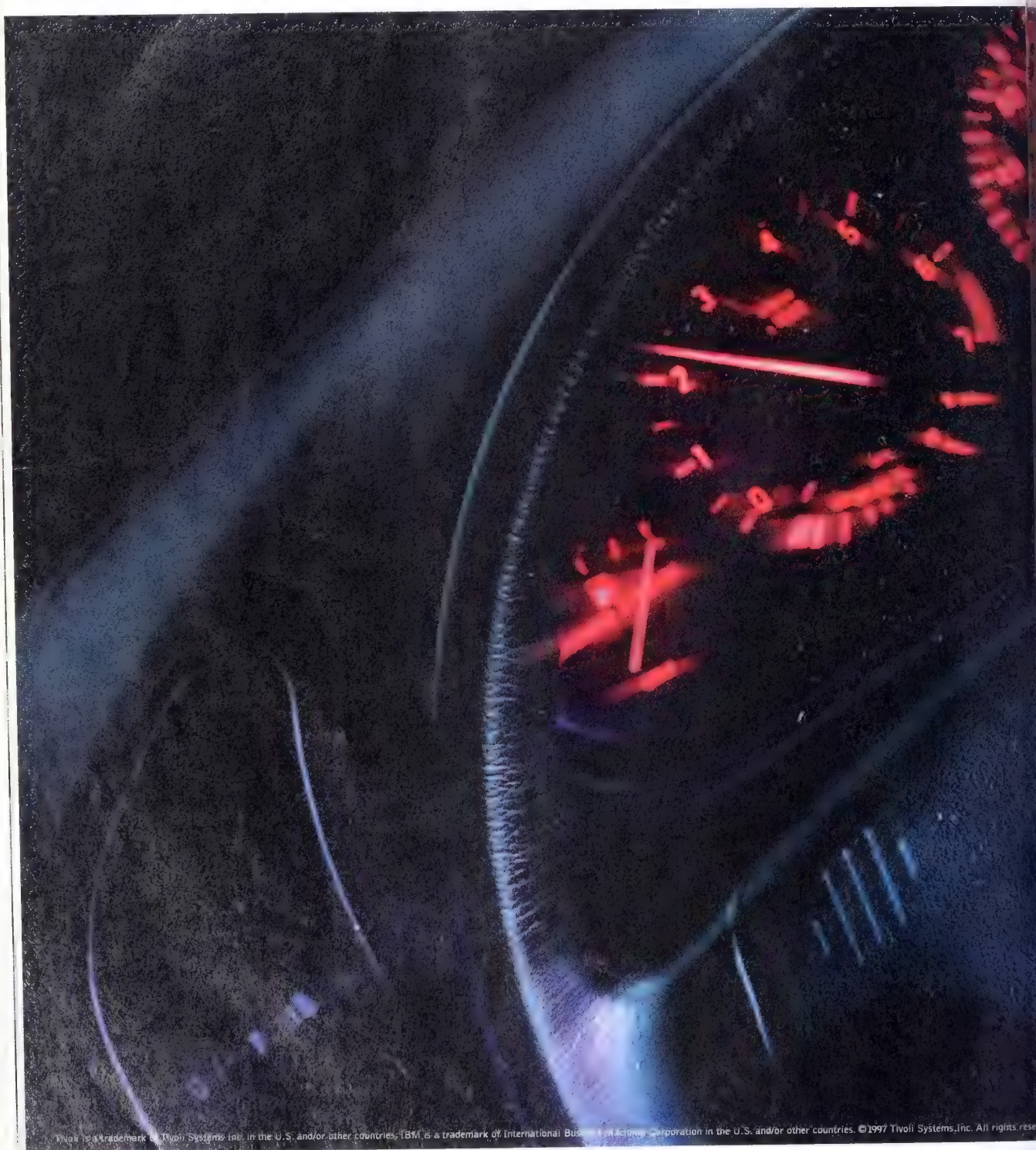
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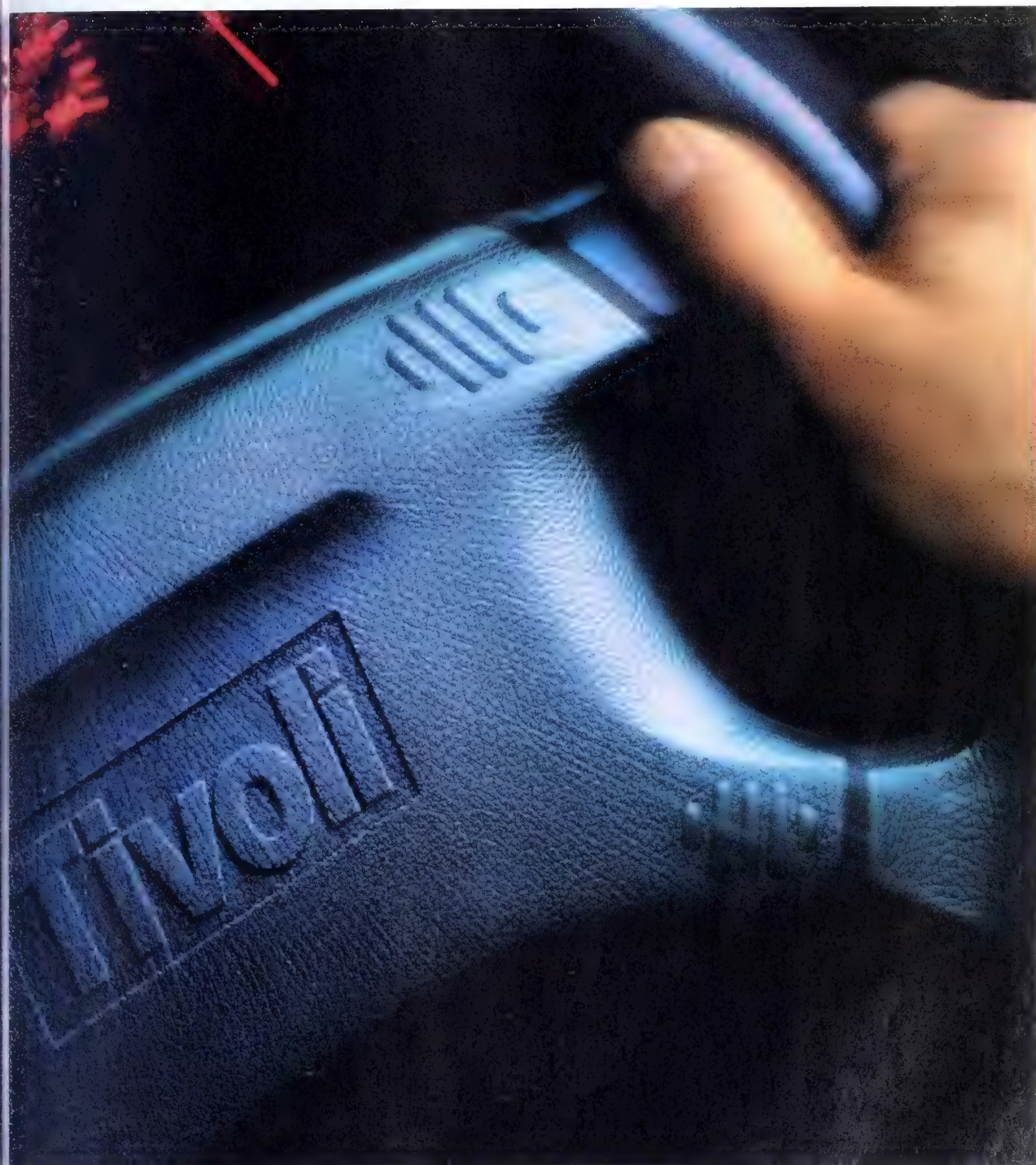


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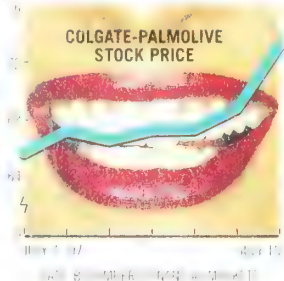
ITT SHOWS HILTON THE DOOR

ITT CHAIRMAN RAND ARASKOG appears to have successfully fended off Hilton Hotels' \$10.5 billion bid for his conglomerate by moving on July 16 to split ITT into three public companies. Hilton President and CEO Stephen Bollenbach blasted the plan. But ITT's share price jumped 6.9% on the news, and many analysts think Hilton's only option now is to raise its bid from \$55 a share to more than \$70. Under the plan, ITT would become three separate entities—ITT Destinations, including Sheraton Hotels and Caesars World casinos; ITT Educational Services, which operates technical schools; and ITT Corp., holding the telephone-

CLOSING BELL

SMILE

America hasn't tried Colgate-Palmolive's Total yet, but Wall Street likes it already. After the FDA on July 14 O.K.'d marketing the toothpaste in the U.S. as the only one that can fight gum disease, Colgate's stock soared more than \$4, closing at 73%. "It's bad news for Procter & Gamble," says PaineWebber analyst Andrew Shore. P&G, which has 27% of the \$1.5 billion U.S. market compared with Colgate's 20%, will fight back with Crest MultiCare. Analysts expect Total to add \$4 a share to Colgate's earnings by 1999.



directory publishing business. The new companies will be structured to make hostile bids next to impossible.

WILL CAMPBELL CLEAR ITS PANTRY?

DALE MORRISON IS MOVING mm-mm fast at Campbell Soup. Morrison was just picked to succeed David Johnson as CEO on June 30. Two weeks later, Campbell said it might divest businesses with sales totaling \$1.4 billion. While the company wouldn't say which assets it might shed, Prudential Securities analyst John McMillin figures the frozen-food business and Vlasic pickle line could be on the block. Morrison also needs to boost revenue growth. He did manage to turn around Campbell's Pepperidge Farm unit before being named CEO.

REYNOLDS MAY CAN ITS CAN BUSINESS

NO CAN DO: REYNOLDS metals is considering a sale of its \$1 billion can division. The sale would remove the company from a brutal market. While Reynolds and archrival Alcoa stole the beverage-can business from steel in the 1970s, they're now running into a tough new rival. Plastic bottles, especially the new 20-ounce models, are a big hit with consumers. Although more costly for beverage makers than aluminum, the plastic battles have encouraged consumers to buy larger containers—and more sodas, according to Coke. And that puts a big dent in the prospects for aluminum cans.

BITTER AFTERTASTE OF A SUGAR DEAL

A SUGAR DYNASTY IS EXTENDING its reach from fields to sugar bowls. Florida Cryst-

HEADLINER: ALEX TROTMAN

IN THE PASSING LANE

Alex Trotman is sitting pretty. Ford's second-quarter profit of \$2.5 billion was an industry record and well ahead of rival General Motors' \$2.1 billion. Now, the Ford chairman says his company, the world's No. 2 car-maker since 1932, could even pull ahead of GM. "Our goal is to be the best automotive company in the world, and that may result in us being the biggest," he told BUSINESS WEEK on July 16.

In June, Ford came within a few car lengths of overtaking GM. GM's U.S. market share tumbled four points, to 28.4% in the quarter, while Ford's

surged more than two points, to 26.9%. GM CFO J. Michael Losh blames its share loss on lengthy strikes and pledges his company's market share will top 31% by yearend.

Ford has stalled before. It set a profit record in second-quarter '96, then tumbled in the fall, leaving it with Detroit's worst profits in '96. Analysts expect a second-half squeeze this year, too. But Trotman vows to cut incentives to buoy margins. "We have a green flag flying, and we're going around the track in fine fashion," he boasts.

By Keith Naughton



tals, the sugar-producing subsidiary of Flo-Sun, the private holding company owned by the Fanjul family, said on July 15 that it plans to merge with Savannah Foods & Industries, a refiner and distributor of sugar, including the Dixie Crystals line. The combined company will have revenues of approximately \$1.5 billion, and Alfonso Fanjul will become chairman and chief executive officer. Savannah's shares dropped \$0.88, to \$14.88, as some investors signaled unhappiness that the terms are too sweet to the Fanjuls.

SMOOTHING THE WAY FOR EPILEPTICS

IT'S A MILESTONE IN EPILEPSY treatment. On July 16, the Food & Drug Administration approved the first new therapy in 100 years for the estimated 2.5 million Americans who suffer from epilepsy. De-

veloper Cyberonics in Webster, Tex., sells a tiny, battery-powered, pacemaker-like implant for \$9,000. Via electrodes attached to a nerve in the neck, the device sends regular electrical signals to the brain that reduce seizures. In patients who do not respond to drug therapies, the Cyberonics device reduced by half the number of seizures in some 45% of patients tested, says Chief Executive Officer Robert Cummins.

ET CETERA...

- Clinton will extend to provisions of the Helms-Burton Act for six more months.
- Microsoft passed Coca-Cola to become the second most valuable company.
- The Feds executed 36 criminal search warrants against Columbia/HCA Healthcare.
- LTV closed its last Pittsburgh-based steelmaking operation.

EDITED BY OWEN ULLMANN

HOW DONORGATE IS KEEPING THE DEMOCRATS IN DEBT

When President Clinton tapped two business-savvy pols to run the Democratic National Committee last winter, they developed an ambitious plan to save the scandal-ridden party from financial ruin. But instead of navigating an style turnaround, DNC General Chairman Roy Romer and National Chairman Steven Grossman seem more like helmsmen at a listing Apple Computer. The problem: Donorgate hearings and criminal probes into campaign abuses are spooking givers and running up legal bills. So with the party still \$15 million in the red, Romer—who also is Colorado's governor—and Grossman have developed a new rescue plan. It calls for squeezing costs and increasing revenues through fund-raisers, direct mail, and such marketing tools as city credit cards.

POLITICALLY NAKED. If this effort fails, Democrats could be in desperate straits in 1998 as they compete with well-financed Republicans. After that, Vice-President Al Gore is hunting on a smoothly functioning DNC to ease his way into the White House in 2000. "If they can't dig out, we're going to be politically naked going into '98 and beyond," frets a veteran Democratic campaign manager.

But digging out is proving difficult. In the first six months of this year, the DNC raised \$19.4 million. The Republican National Committee, with only \$4 million in the red, pulled in \$24.6 million during the same period. Some Democratic fund-raisers are frustrated at the response they have been receiving. "People are afraid of getting subpoenaed—or subpoenaed—even if they did nothing wrong," says one money-chaser. In addition, many liberal givers, notably the entertainment elite, have become alienated by the incessant big-buck campaigns. That's why the Hollywood men's Political Caucus disbanded, for example.

In addition, a number of corporate donors who have played both sides of the giving street are reluctant to anger their friends in the GOP Congress by donating to the Dems again. And some Dem loyalists are focusing on the party's separate congressional and senatorial committees—rather than the DNC—because they want their money to pay for campaigns, not defray lawyers' bills and improper-donation refunds.

PRIVATE-SECTOR PARALLELS. Grossman, president of Massachusetts Envelope Co., is keenly aware of the pressures on him. In meetings with donors, fund-raisers, and local party officials, he explains that he can trim the DNC budget by \$5 million through such savings as reduced payments to consultants and pooling of state-party business to win volume discounts for direct mail, phone banks, and other services. To ratchet up income, President Clinton has agreed to participate in eight DNC events this year, and Gore has committed to a dozen. Grossman insists that it will only require 15% of the committee's projected 1997-98 revenues of \$100 million to eliminate the mountain of debt by his target date of December, 1998. "Roy and I have got our situation well in hand," he says.

Perhaps they do. Democratic business executives such as Sybase Inc. CEO Mitchell E. Kertzman see private-sector parallels in their party's slower-than-expected revival. "It's a classic corporate turnaround situation," says Kertzman, a Grossman friend. "Things are usually more broken than they appear on the surface and usually take a lot longer than you think to fix."

Unfortunately, the party doesn't have the luxury of time. If it lacks the dough to sell its message to voters in '98, the DNC, like Apple Computer, could face the prospect of a reduced market share.

By Richard S. Dunham



CAPITAL WRAPUP

WHAT CHINA POLICY?

U.S. foreign-policy hands are fretting that the Clintonites have allowed China policy to wither because of the donorgate scandal. Critics say there has been a fall-off in senior- and working-level exchanges with Beijing, and talks over China's entry into the World Trade Organization have languished. As a result, some China experts say that President Clinton and Chinese President Jiang Zemin may have little to talk about when the two meet in Washington this fall.

RAILING OVER A CLINTON PICK

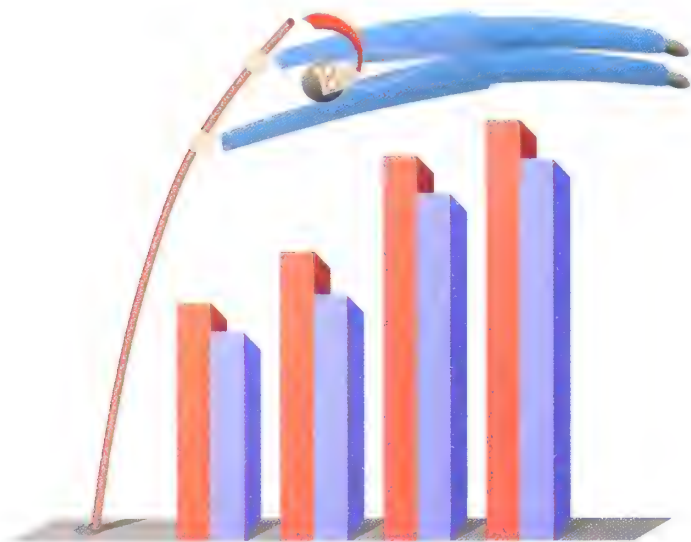
► To please the Congressional Black Caucus, President Clinton may name a cousin of caucus member James E. Clyburn (D-S.C.) to the Surface Transportation Board, which reviews railroad mergers. William Clyburn, 31, an aide to Senator Charles S. Robb (D-Va.) is in line for the \$115,700-a-year job. But top senators, such as Majority Leader Trent Lott (R-Miss.) and Minority Leader Thomas A. Daschle (D-S.D.), are angry. Their choice: Clyde J. Hart Jr., the top Commerce Committee railroad staffer.

A BAD EXPERIMENT?

► Industry, academe, and even government scientists want to put the kibosh on an Environmental Protection Agency proposal to regulate air emissions from research and development labs. "This is the dumbest idea in awhile," huffs Intel Corp. lobbyist Timothy Mohin. The fear: Forcing labs to comply with rigid standards on pollutants would stifle innovation, especially when few labs would be major polluters. The EPA contends that the Clean Air Act requires it to regulate labs.

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JPMorgan

GERMANY

'THE GERMAN WORKER IS MAKING A SACRIFICE'

With jobs fleeing the country, unions agree to lower wages and higher productivity

Hans-Gunter Eidtner felt like the first officer on a jet that was losing altitude with sickening speed. Head of the works council at the Hamburg factory of struggling Daimler Benz Aerospace (DASA), Eidtner faced the ugly prospect of 800 fellow workers losing their jobs by the end of 1998. But the 60-year-old labor boss last month averted disaster, persuading the powerful IG Metall union to O.K. concessions, such as axing overtime pay. "We had a big fight" to push through the givebacks, says Eidtner.

Such a deal would have been unthinkable a few short years ago. Historically, Germany's big unions forced companies to accept nationwide "pattern" contracts, a practice that gave them enormous power. Ailing steelmakers in the north had to give workers the same cushy contracts as thriving carmakers in the south. But now, with a near-record 4.3 million people out of work and jobs fleeing the country, workers suddenly are eager to compromise. What began as a trickle of reform at stumbling midsize companies in eastern states quickly has spread to Germany's biggest companies. "The German worker is making a sacrifice," says Hubertus von Grünberg, chief executive of tire-maker Continental.

SNOOZING ECONOMY. Such flexibility, plus a wobbly German mark that is making German exports cheaper on world markets, are giving the snoozing economy a boost. Economists figure growth could rise to 2.25% this year and 2.75% in 1998. Moreover, the steadily rising jobless rate, now 11.4%, may finally have reached a plateau.

The bad news is there's no sign that unemployment lines will shorten anytime soon. Modest growth means that only about 120,000 additional people will find work by the end of 1998, fig-

ures Kurt Vogler-Ludwig, a labor economist at the IFO Institute for Economic Research in Munich. "It'll take a miracle" to change the situation, he laments.

But German business, on a campaign to boost profits and shareholder value, is pushing ever harder to restructure. Increasingly, companies are cutting deals with workers that improve productivity and flexibility (table). Most negotiate concessions with the works councils at individual factories or subsidiaries, then gain reluctant approval from national unions. Some even sever all union links and deal directly with workers. At

DASA's Hamburg plant, which assembles Airbus 319 and 321 jets, some employees will shift to a 40-hour work week up from 35 now. All 7,000 workers agreed to up to 100 hours of overtime a year without extra pay, in return for free time when demand slackens.

Such deals are most common in eastern Germany. That's because, ironically, unions have less clout in the former communist zone. Moreover, companies there, unable to compete in a market economy, have scrambled to slash labor costs. In Saxony, for instance, only about 8% of companies in the electrical m-



NEAR MISS

The union at Daimler Benz gave up overtime pay to avert job cuts

working industries are bound by
ern contracts, says Dietmar Voigt,
official at the regional employers fed-
on in Dresden. The rest have cut
own deals—either with or with-
he consent of IG Metall, Germany's
st union.

the west, small and midsize com-
as were first to jump on the band-
on. At Gustav Selter Ltd., a knit-
needle maker near Dortmund that
oys 40 people, workers have agreed
flexible working hours and pay cuts
ing 16% since 1994. In return, they
receive a share of profits. Sales are
ing 15% a year, vs. just 5% before
concessions were implemented, and
ts should jump nearly 50% in 1997,
owner Thomas Selter. "At the
s roots, major change is under way."
s trickling up, too. One German
n has decided to support the trend
ard company-tailored contracts. IG
mie-Papier-Keramik, the nation's
d-largest labor group with 725,000
bers, in June struck a ground-
breaking, industrywide deal. It allows
l-pressed companies to reduce pay
as much as 10% in return for job
rity and commitments for further
stment in German operations. Al-
gh the contract doesn't go into ef-

A near-record 4.3 million people are out of work, and unemployment lines are unlikely to shorten soon. "It'll take a miracle," says an economist

fect until January, about 50 companies already are negotiating to take advantage of the new provisions.

Such shifts are contributing to a productivity boom. After accounting for inflation, productivity jumped by 4.6% in 1996, nearly a percentage point faster than the last year productivity surged—after unification in 1991—according to the Institut der Deutschen Wirtschaft in Cologne. As sales pick up, the improvements are boosting corporate earnings. At the 30 companies represented in the DAX stock index, profits jumped an average 45% in 1996—one reason German stocks are flying so high. The DAX has steadily set new records this year, gaining more than 40% since January.

Will workers reap the rewards of their newly accommodating spirit? Unfortunately, even over the medium term, most of Germany's new labor agreements aren't likely to boost employment. That's because most simply give

other bout of radical surgery. Says DASA's Eidtner: "Each one of us knows that in three or four years, when the [aircraft] boom is over, we'd have exactly the same problem as before."

Indeed, until Germany undertakes far more sweeping structural reform of its labor market and regulatory system, companies will have to struggle to stay globally competitive. Even with the mark hitting a six-year low against the dollar, 1.79 on July 15, Germany's wage costs are still the world's highest. And social security taxes, which Chancellor Helmut Kohl pledged to cut to less than 40% of gross wages, are actually headed toward 42%, in part because of the added costs brought on by high unemployment.

BALLOONING TAB. Kohl's embattled government is unlikely to help lower the cost of doing business anytime soon. The chancellor faces tough parliamentary elections next fall: Polls show that the opposition Social Democrats have

increased their lead over Kohl's Christian Democratic Union to as much as eight percentage points. And Germany's costly social safety net—about \$19,000 annually per unemployed person—caused a budget crisis in early July. A supplementary emergency budget unveiled by Finance Minister Theo Waigel added \$10 billion in government borrowing to help pay the tab. But the bleak employment outlook—and legislative gridlock in Bonn—ensures that the crisis will spill over into 1998.

The governing coalition's tax-reform plan to cut rates for individuals and companies also looks moribund, a victim of political wrangling. "Nothing's going to happen until the end of 1998, after the elections," says Thomas K. Bentz, a co-owner of Melitta Group, the Westphalia coffee company.

But business has long since stopped waiting for Bonn to get moving on tax and regulatory reform. Companies continue to shift some labor-intensive operations to lower-cost locations. And in their relentless pursuit of efficiency, they are finding that with workers back home, they have more leverage than ever before.

By David Woodruff in Frankfurt

WHERE GERMANY IS BREAKING THE LABOR MOLD

Bayer The chemical union agrees to reduce bonuses, ax an employee share-purchase program, and introduce flexible work hours over three years.

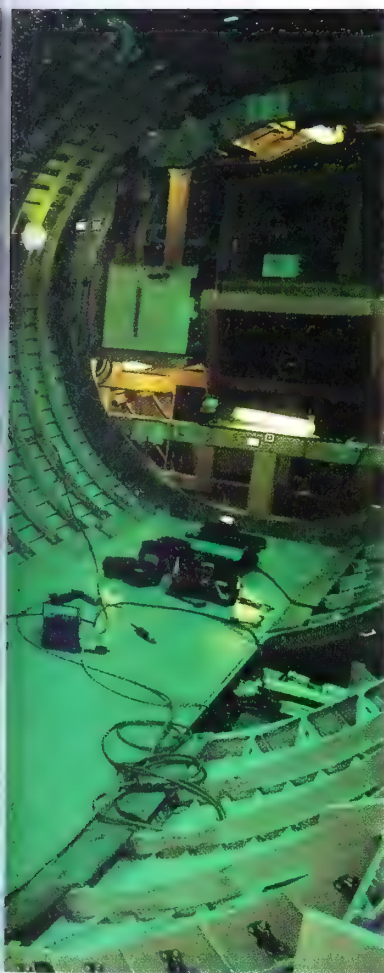
Volkswagen The IG Metall union has agreed to a two-tier wage system. Temporary workers will earn 10% less than current employees.

Continental Workers at the Hanover tire plant will increase their workweek by 75 minutes and make other concessions worth about \$20 million.

Daimler Benz Some 1,050 workers will see their normal workweek jump to 40 hours. Temporary workers can be hired for the first time.

Deutz Workers at the machinery maker accept a second year of pay cuts, from 2.5% to 10%, in 1998. In return, workers will receive up to \$11 million in Deutz stock.

companies greater ability to meet increased demand without hiring new staff. It's a huge benefit for employers, since layoffs are so difficult and costly under German law. And some companies will continue to trim payrolls by attrition. But workers are facing the fact that concessions now could forestall an-



CHINA

WILL KODAK GET LUCKY IN CHINA?

Maybe—if Beijing lets it team up with Lucky, the national brand

Yu Lingtao is a popular man. When he opened his small photo shop in mid-1993 in the upscale Beijing suburb of Fangzhuang, customers hurried in with their undeveloped rolls of locally made Lucky film. Yu printed the snapshots on Lucky photographic paper. Then, a Fuji Photo Film Co. salesperson came knocking. With the Japanese company's help, Yu turned his shop into a Fuji outlet and started developing photos with Fuji paper and chemicals.

But two years later, Yu's shop got a new look. Down came Fuji's green logo, and up went the red-and-yellow Kodak sign. Thanks to a \$2,000 enticement from the Rochester (N. Y.) company, Yu's store became one of some 2,000 Kodak affiliates in China. "They offered me more," says the dapper Yu.

Sweeping up small Chinese entrepreneurs is just one of the aggressive tactics Eastman Kodak Co. has employed to seize a 41% share of China's fast-growing \$250 million market for photographic film. Now, Kodak hopes to shift into overdrive and plow some \$375 million into manufacturing, including a tie-up with now struggling China Lucky Film Corp. That would enable Kodak to avoid China's 60% duty on imported film and dominate what is expected to be the world's second-largest film market in a decade. And for state-owned Lucky, whose market share has plunged from 24% to 7% since 1994, it could mean rescue from ruin.

CAUSE CELEBRE. A classic win-win situation? Not the way Chinese nationalists see it. While terms of the deal have not been disclosed, they fear that allowing Kodak to manufacture locally will mean death for another major Chinese brand. As a result, activists are seizing on Lucky as a cause célèbre in a campaign to beat back the advance of multinationals. Now before the powerful State Council, the Kodak case is caught up in a national debate over whether the government should prop up domestic producers—or whether foreign in-

vestment should be permitted at all in some consumer industries. Some opponents of the deal even assert that Lucky should be preserved on the grounds of national security since China's military is a major customer.

The verdict of Chinese consumers seems clear. They overwhelmingly prefer Fuji and Kodak despite the government's best efforts. Because of high du-



Local media say Fuji and Kodak are dumping in China. Yet their film and paper cost 50% more than Lucky's

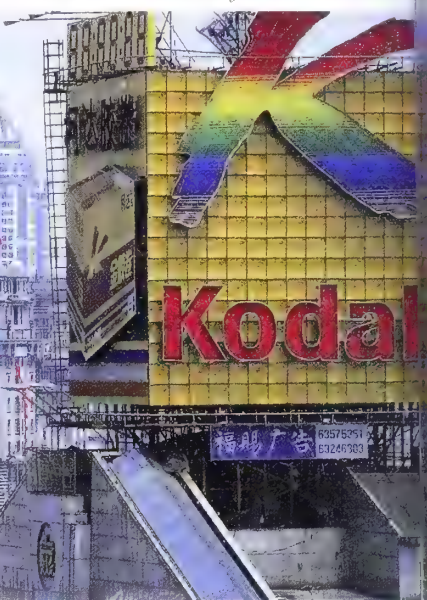
ties, an estimated 65% of film and photographic paper sold in China is smuggled in through a thriving gray market. The government bars foreign companies from manufacturing film locally or owning retail outlets. And because policies change constantly, says Koji Yokota, managing director of Fuji Photo's Beijing office, "the road ahead is hard to see in China."

Still, Kodak is accelerating. For the past two years, its army of 500 marketing employees has been signing up an average of three new exclusive retail affiliates a day by offering shopkeepers discounts on supplies and financial help

to renovate. With sales growing by annually, Kodak hopes to overtake whose market share now stands at "China is one of the key growth kets for us," says Kodak China C man Patrick T. Siewert.

CLOSELY WATCHED. But the big p would be the proposed joint ven with Lucky. First, it will take a v for the furor to die down. Local m for example, allege that Kodak and dump their products in China. The eign companies say that's ridiculous, ing that their film and paper are more expensive than Lucky's. Ne theless, a lobby led by the National sociation of Light Industry is urg

SHANGHAI: No decision is likely to be reached until the fall at the earliest



the government to provide \$240 million in cash and low-interest loans to rescue Lucky while maintaining a ban on joint ventures in film manufacturing.

With the case also being watched closely by the foreign business community, Chinese leaders don't want to do anything rash. When Premier Li Peng visited Lucky in mid-July, he did not mention the Kodak bid. But Li did say foreign investment should be considered. No decision on the venture is expected until after the crucial 15th Party Congress this fall, if then. "The whole question has become a very sensitive matter," says one official at the Chemical Industry Ministry, which is responsible for overseeing Lucky. If the ruling goes against Kodak, investing in China may not be a pretty picture for lots of multinationals.

By Dexter Roberts in Beijing, with Joyce Barnathan in Hong Kong



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EDITED BY PETE ENGARDIO

JAPAN: HASHIMOTO'S PARTY RIDING REFORM TO TRIUMPH

financial scandals, yawning budget deficits, a fits-and-starts economy. Such things usually spell death to political careers. Not so with Japanese Prime Minister Ryutaro Hashimoto. After 19 months in office, Hashimoto is shaping to be the most effective Japanese leader at home and abroad since Yasuhiro Nakasone in the mid-1980s. One big reason is that his Liberal Democratic Party, once viewed as beholden to vested interests, has outmaneuvered rivals by leading for economic reform. Concedes a senior member of opposition New Frontier Party: "They have played their cards very deftly."

That much became clear on July 6, when the LDP triumphed in Tokyo metropolitan elections by increasing its seats in the local council 40%, to 54, in a race widely viewed as a harbinger of national trends. The New Frontier Party, the reformist but feud-ridden group led by former LDP kingpin Ichiro Ozawa, was soundly defeated. And in the 500-seat Diet, the powerful lower house of parliament, so many New Frontier members have defected to the LDP that Hashimoto's party is just three seats shy of regaining the majority control it lost in 1993 after four decades in power.

IG HO. The LDP's revival owes much to Hashimoto's assertive style, which plays well with a public anxious about the stumbling economy and resentful of Washington's lecturing. Last month, Hashimoto spooked Wall Street by hinting that he might sell off its Treasury bonds if the U.S. used the yen as a trade weapon. It was an idle threat, but many Japanese were privately delighted. And in Japan's first unilateral military action since 1945, Hashimoto sent three C-130 transport planes to Thailand for a possible evacuation of Japanese nationals from Cambodia.

These are easy victories, though, compared with the work that awaits Hashimoto. He's under pressure from Washington

to win Diet approval for a new security agreement this fall that calls for Japan's military to give the U.S. more backup during regional conflicts. The LDP's left-leaning coalition partners, including the Social Democratic Party, are likely to attack such plans. Another challenge is to tame the squabbling among the LDP's *zoku-gin*, or special-interest groups, which still press for bullet train lines and other goodies in their districts even as Hashimoto tries to close the deficit.

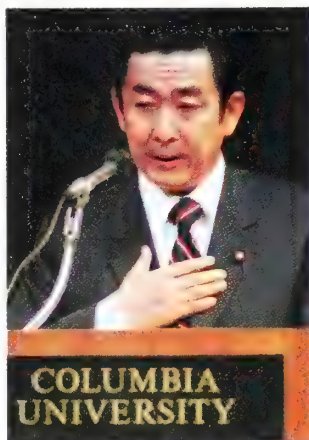
CHANGE PARTNERS AND DANCE? A bigger dilemma for Hashimoto is whether the LDP should dump its shaky coalition partners and tie up with the New Frontier Party. By embracing reform, he has pushed the LDP much closer to the New Frontier on many issues. LDP leaders such as Chief Cabinet Secretary Seiroku Kajiyama are open to a formal New Frontier alliance. But others, including Secretary-General Koichi Kato, oppose it, since they want to punish the LDP renegades who founded New Frontier.

Hashimoto needs to keep these rifts from endangering his broad reform drive. Voters and global investors praise his plan to overhaul Tokyo's inefficient financial markets by early next century, but bureaucrats still resist. He also aims to downsize the bloated government and open long-protected service sectors such as wholesale distribution and utilities to more foreign competition. Many smaller companies are

bound to fight such threats to their franchises.

Another danger is that without any serious opposition, the LDP will be tempted to sidestep meaningful reforms. But with the economic and social challenges facing Japan, Hashimoto and the LDP know that by abandoning all pledges to initiate serious change, the party could find itself back in the wilderness. The only way out is for Hashimoto to complete the difficult task he started.

By Brian Bremner in Tokyo



HASHIMOTO: *Deft player*

GLOBAL WRAPUP

EUROPEANS BRUSH OFF D'AMATO

Senator Alfonse D'Amato (R-N.Y.) is trying to turn up the heat on European companies doing business with Iran—but he's not having much luck. On July 10, he sent a scathing letter to Germany's Westdeutsche Landesbank accusing it of violating the "spirit" of U.S. sanctions. The bank helped finance a \$90 million loan for Iran to buy European equipment and services to develop its Soroush gas field. The bank says the sanctions bar investments in Iran, but not loans.

France's Total is expected to soon finalize a bigger gas-field deal in Iran. Europeans are likely to keep ignoring D'Amato now that Iran has a more moderate government and better economy.

HONG KONG LEGAL CHALLENGES

► Cases making their way through Hong Kong's courts could soon delve into far-reaching questions about the judiciary's independence under Chinese rule and the legality of actions by the Beijing-appointed Provisional Legislative Council. Among the most

important: In an effort to keep thousands of children from being deported to China, their attorneys argue that a law passed on July 10 by Legco violates right-of-abode guarantees in Hong Kong's constitution. Pro-Beijing lawmakers claim Hong Kong courts have no jurisdiction because only China's National People's Congress can overturn Legco-passed laws. If the court hears the cases, that could set the stage for challenges to many new laws, such as rollbacks in civil liberties, and for a political battle with Beijing.



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TURNAROUNDS

O.K., HE CUT COSTS. NOW CAN HE SELL NEWSPAPERS?

Having put Times Mirror into fighting trim, Mark Willes aims to jazz up marketing

Mark H. Willes smiles faintly at the memory of his first months at Times Mirror Co., when his cost-slashing won the onetime General Mills Inc. vice-chairman the epithets "cereal killer" and "Captain Crunch." "It didn't bother me," Times Mirror's chairman and CEO says coolly.

It's easy to be blasé when you're on a roll. Since mid-1995, when Willes became the first outside exec brought in to run the family-controlled company, he has moved fast. He shocked observers with an opening gambit that shuttered such papers as *New York Newsday* and Baltimore's *Evening Sun* and slashed nearly 3,000 jobs, or 10% of the workforce. The cuts raised operating margins from 8% in 1994 to 12% last year, and the stock price has zoomed to about 58% from 23% when Willes arrived. "You have to love the job he has done," says Mark Greenberg, Leisure Strategic Fund manager at Invesco Funds Group, which owns about 90,000 shares. "He's made the right moves by getting rid of things that weren't working, and he's got people working for him thinking they can grow their business."

UP FROM BLEACH. Already, the moves have buffed earnings. Greenberg thinks 1997 net income will hit \$267 million, up 30% from the \$206 million earned on sales of \$3.4 billion in 1996. Now, Willes, 55, must find growth at a company where two-thirds of sales and 76% of earnings come from the slow-growth newspaper business. But to Willes—who spent 15 years at a place where promoting Cheerios was an art—it's Marketing 101. To lure readers to such papers as the *Los Angeles Times*, *Newsday*, and the *Baltimore Sun*, he is jazzing up their look, using promotions, and speeding distribution. "If you can increase the sales of something as bland as bleach," he says, "you ought to be able to do it for something as wonderful as a newspaper."

Getting readers to pick up a newspaper when they're inundated with TV,

radio, and the Internet is harder than slapping Michael Jordan on a Wheaties box, however. Investment bankers at Veronis, Suhler & Associates Inc. think the industry's total 1997 circulation will reach just 59.4 million, down 5% from 1989. "Gaining circulation is a zero-sum game," says Salomon Brothers Inc. analyst Lanny Baker. But Willes sees a silver lining. With a consoli-



dation under way and a healthy national economy boosting ad sales across the board, he plans to scoop up papers that dominate their markets. "Newspapers aren't dead," he asserts.

So far, however, Willes' wiles have shown mixed results. In the six months ended in April, daily circulation at Times Mirror's seven papers rose 2.4% overall, to 2.3 million, with the *Times* up nearly 5% from the 1996 period. Yet daily circulation is up by only 0.7% at *Newsday*, its second-largest paper, and the more profitable Sunday circulation is down at five of seven papers, including the *Times*. Market saturation is partly to blame, says Willes.

His best chance to grow is in Los Angeles, where the *Los Angeles Times* battles more than 20 smaller papers in such nearby cities as Pasadena. With 1.1 million daily readers, the *Times* holds just 30% of the market and contributes more than one-third of Times



WHAT WILLES HAS DONE

- ▶ Shuttered *New York Newsday*, *Baltimore's Evening Sun*, *The Sports Illustrated Dealer*, and several *Los Angeles Times* sections.
- ▶ Exited consumer multimedia business, cable programming, and an electronic shopping joint venture with Pacific.
- ▶ Swapped college publishing business with McGraw-Hill's Shepard's putting it then sold 50% to Reed Elsevier's Nexis subsidiary.

or's revenues and two-thirds of operating earnings. To win new readers, es has imported some cereal tactics—including price cuts, heresy to y in the newspaper world. "It was kind of guerrilla warfare we never to use before," says Richard T. osberg III, the longtime head of es Mirror's newspaper group. In 1996, Willes halved the *Times*' sin-issue price, to 25¢. He also launched a million advertising campaign—the er's first since 1989—began retailer notions, and put the *Times* logo on ts venues such as the Los Angeles m. Says Theodore Lutz, vice-pres-t at *The Washington Post* for busi-

ness development and circulation: "It's nice to see someone who believes in marketing again for this industry, and it's nice to see someone who's showing numbers after doing it."

Certainly, L.A.'s resurgent economy hasn't hurt. With the entertainment sector briskly adding jobs, the *Times* has increased advertising by expanding its business pages with tech and small-business sections. Orange County is the only major local market that the *Times* has not cracked. Despite promotions at baseball games and food-fair giveaways, circulation is flat, and the paper is outsold 2 to 1 by the *Orange County Register*, which sells itself as the local alterna-

hand from low newsprint prices, which made up 13% of 1996's costs. In the first quarter of 1997, the newsprint price was about \$550 per metric ton, down 30% from the previous year. But prices are firming, and the company projected in a May analysts meeting that they could hit \$650 by 1998. To slash costs, the company has jammed classifieds and comics into fewer pages. Willes is testing a price-hedging program, but the hikes may still hurt margins.

Willes has also moved to consolidate Times Mirror's publishing arm, which made up 29% of 1996 sales but just 18% of operating earnings. On Apr. 16, he merged its Matthew Bender & Co. legal

APPETIZING NEWS

Promo efforts have ranged from *Times* giveaways at food fairs to Burger King snacks for first-time *Newsday* subscribers



books with Mosby-Year Book Inc., a health publisher. A key thrust will be electronic health and legal information for professionals. Willes also hopes to create an information powerhouse: After acquiring The McGraw-Hill Companies' Shepard's legal citation unit, he put it into a joint venture with Reed Elsevier's PLC's Lexis- Nexis unit.

Willes is experimenting with the Internet as well, investing in such services as ListingLink for real estate and the Hollywood Online Inc. entertainment service. While profits have been elusive, Willes thinks that Net services that act like classified advertising complement his newspapers. "I'm not sure we can make money there," he says, "but I want to be there just in case."

What next for Willes? With little left to chop, he has been shopping for more papers, although he lost a recent bid for a group of newspapers owned by the Walt Disney Co. to Knight-Ridder Inc. Still, Willes remains sanguine on the possibilities for his industry. "There is still nothing that can beat getting up in the morning with your newspaper and a cup of coffee," says Willes. "And we think if you make it appealing, more and more people will do just that." With that, even the "cereal killer" smiles.

By Ronald Grover in Los Angeles



STILL TO DO

declining circulation at Sunday newspapers such as more *Sun* and the *Los Angeles*

rising newsprint prices after down years. Newsprint makes of Times Mirror's costs.

regionally targeted online and others aimed at als—in the face of intense on.

tive to the nationally minded *Times*.

Room to grow is just as limited in the next two largest markets, Long Island, N. Y., and Baltimore. There, *Newsday* and *The Sun* already reach more than half the homes. *Newsday* was forced to retreat to its Long Island base in 1995 after losing \$100 million in a five-year fight to wean New York City readers away from the likes of *The New York Times* and the *Daily News*. "I think *New York Newsday* was a large distraction," says *Daily News* CEO Fred Drasner. "They're better off focusing on their core audience."

DIFFERENT STROKES. Each region requires its own tactics. On Long Island, where *Newsday* has been plagued by late deliveries, 75 minutes have been shaved off the distribution process so sports deadlines could be moved back. A deal with Burger King Corp. offering food prizes for new Sunday subscribers has boosted circulation by 2,500 since mid-1996. *Newsday* also is targeting younger readers with nightlife and high-tech sections. In Baltimore, Willes replaced the unionized advertising sales force with a commission-based staff.

Willes' overhaul has also gotten a



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LIKE A ROCK

SOMEONE'S IN THE KITCHEN WITH MARTHA

Sharon Patrick, Stewart's president, aims to make the domestic doyenne the "first true multimedia brand"

Martha Stewart is at a gala sipping a glass of turquoise champagne to match her cashmere jacket and costume jewelry when she turns to her new chief executive. "Doesn't this remind you of the blue skin of a scarab beetle, Sharon?" Sharon Patrick—her own beer-hued pantsuit clashing with the drink—chokes out a boisterous laugh. "Martha, how am I supposed to know what a scarab beetle looks like?"

Sharon Patrick can't distinguish between garden bugs. She doesn't bake breathtaking cakes, spin sugar, or raise her own chickens. But since they met four years ago climbing Mt. Kilimanjaro, the former McKinsey & Co. consultant and America's domestic doyenne have become so intertwined that they now share an office and work head-to-head at antique French postmaster's desks. "Martha fell in love with Sharon's mind," says Charlotte Beers, chairman emeritus of Ogilvy & Mather Worldwide Inc. and a mutual friend.

DIPLOMATIC TONGUE. What's not to love? This is the mind, after all, that in February pulled off the buyout of the prized Martha Stewart Living Enterprises from Time Inc., finally turning America's favorite hostess into a full-fledged corporate entity 15 years after she published her watershed book, *Entertaining*. For two years, Stewart had tried to take control of her signature magazine, books, and mail-order catalog. But it wasn't until Patrick came along with her diplomatic tongue and tough negotiating tactics that Time agreed to sell more than 80%, for roughly \$75 million. "Sharon is great at bringing warring parties together," says Joseph Ripp, Time's chief financial officer. "Without Sharon, there would have been no deal."

And without the deal, there would be no Martha Stewart Living Omni-

media—an empire that sprawls over three floors of a landmark building in midtown Manhattan. There, 160 people create the recipes, gardening tips, and housekeeping advice that Stewart will preach to millions. Patrick's job is to spread the gospel over every mass-market medium. Until recently, Stewart's mainstay was the magazine that carries her message to 2.2 million people. But this year, *Martha Stewart Living* will generate only a quarter of some \$200 million in sales. The rest will come from books, a television show, weekly appearances on CBS's *This Morning*, her catalog, and a mushrooming line of products. Stewart just signed a deal for her own daily radio show and by fall will hawk her wares at a pay-as-you-go Web site. Now, even top media analysts don't quibble with Patrick when she vows: "Martha Stewart is about to be the world's first true multimedia brand."

Patrick, a tall, blonde San Diego native who swam with the dolphins at Sea World before getting her Harvard MBA, has been yearning to place a brand in all media windows since the early 1980s, when she was a partner at McKinsey. "I always thought it was good economics and the wave of the future," she says. She never found the right client to test her philosophy, but Cablevision Systems Corp. Chief Executive Charles F. Dolan liked her so much that in 1990 he wooed Patrick to become president of his struggling programming arm, Rainbow Programming Holdings Inc. "She has a great power to analyze and organize," Dolan says. By bringing in new programs and eliminating stale ones, Patrick boosted revenues 50%, to \$330 million. When her \$325,000-



NO CREAM PUFF

Patrick is a startup and turnaround person," figured out how to pull together Stewart's empire

a-year contract expired after three years, she left. "I'm a startup and a turnaround person," she says. "When a job is done, it's done."

So when will Patrick walk away from Martha Stewart? "This is an entrepreneurial business," Patrick says. "It will be developing for years and years. I'm here for the long haul." That surprises some acquaintances, given the duo's equally strong egos and diverge

estic bents. "I wondered if Sharon w what she was getting into," says Katzenbach, a McKinsey director. Rick likes to garden on the sprawling ace of her Upper East Side pentse, but looks nervous when asked if sekeeping is her No. 1 priority. "Of se," she gasps. "Isn't it yours?" Like Stewart, Patrick seems to ine either admiration or loathing—er indifference. Talk to her chums, they'll say she's a brilliant busiwoman with a great sense of humor. s to some colleagues, though, and may hear her described as a ruth-

ing a line of 256 Sherwin-Williams paints last year, Stewart poured more than 2,000 mixtures, trying to match things around her house—from her cat's fur to chicken eggs. Some were too expensive to sell for \$14.99 a gallon. "Sharon was able to ground most of the discussions in reality," says T. Scott King, president of the paint company's consumer-brands unit. "Martha's a creative person. Sharon figures out how to bring it to market."

But imply that Sharon is the business brains and Martha is the artist, and Stewart is quick to remind you that

Sharon Patrick

BORN San Diego, 12/30/42.

EDUCATION Stanford University, BA, 1967; Harvard business school, MBA, 1978.

CAREER 1973–1976 Health, Education & Welfare Dept.: Management team.
1978–1989 McKinsey & Co.: Partner; founded media practice.
1990–1993 Rainbow Programming Holdings Inc.: President and COO; Director, parent Cablevision Systems.
1993–1997 Launched her own strategy consulting firm.
1997 Martha Stewart Living Omnimedia: President.

CLAIM TO FAME A savvy dealmaker, she turned Martha Stewart's company into a multimedia corporation, persuading Time Inc. to part with the profitable division, while renegotiating numerous other contracts.

PERSONAL Patrick is single and lives in a penthouse on Manhattan's Upper East Side. Likes gardening on the terrace but avoids the kitchen.

RECREATION Scuba, dancing, baseball, and hiking. Scaled Mt. Kilimanjaro with Martha Stewart.

s opportunist who schmoozes with chief but alienates the rank and file. Sharon doesn't suffer fools easily," an says. Patrick bristles: "Sure I'm nanding. But so are Lou Gerstner Lee Iacocca. If I were a man, I'd be ed a great leader." Patrick talks nonstop—until asked if and Martha always agree. "There's a ical agreement that the company st be profitable," she says simply. parently, Stewart's high-class tastes it always translate smoothly to the ss market. When they were develop-

she was once a successful stockbroker. "Remember, I'm a businesswoman too," Stewart says. "These are all my ideas, and I set all the direction."

Lest there be any doubt about who's in charge, Stewart, who is chairman, recently reclaimed the chief executive title for herself—three months after heralding Patrick's appointment as CEO. Patrick is now president. "Martha isn't as consumed by TV as we thought she would be," Patrick explains. Stewart, calling from her car phone before an appearance with Jay Leno, says: "Ti-

ties. I'd prefer if we didn't have any."

Despite their differences, acquaintances say Stewart and Patrick are extremely close. They often spend weekends at Stewart's East Hampton home and travel the world mixing work with play. "Sharon is not easily daunted," Beers says. "They are very loyal to each other." The pair met four years ago hiking 19,340 feet up Mt. Kilimanjaro, in a trip arranged by the socialite Sandy Hill Pittman. Among Patrick's first memories: The high priestess of home decorating refused to wear the gear. "It was bright green, bright red, bright yellow," Patrick says. "Martha expected to look like *Out of Africa*. I didn't care what I wore. That's the difference between Martha and me."

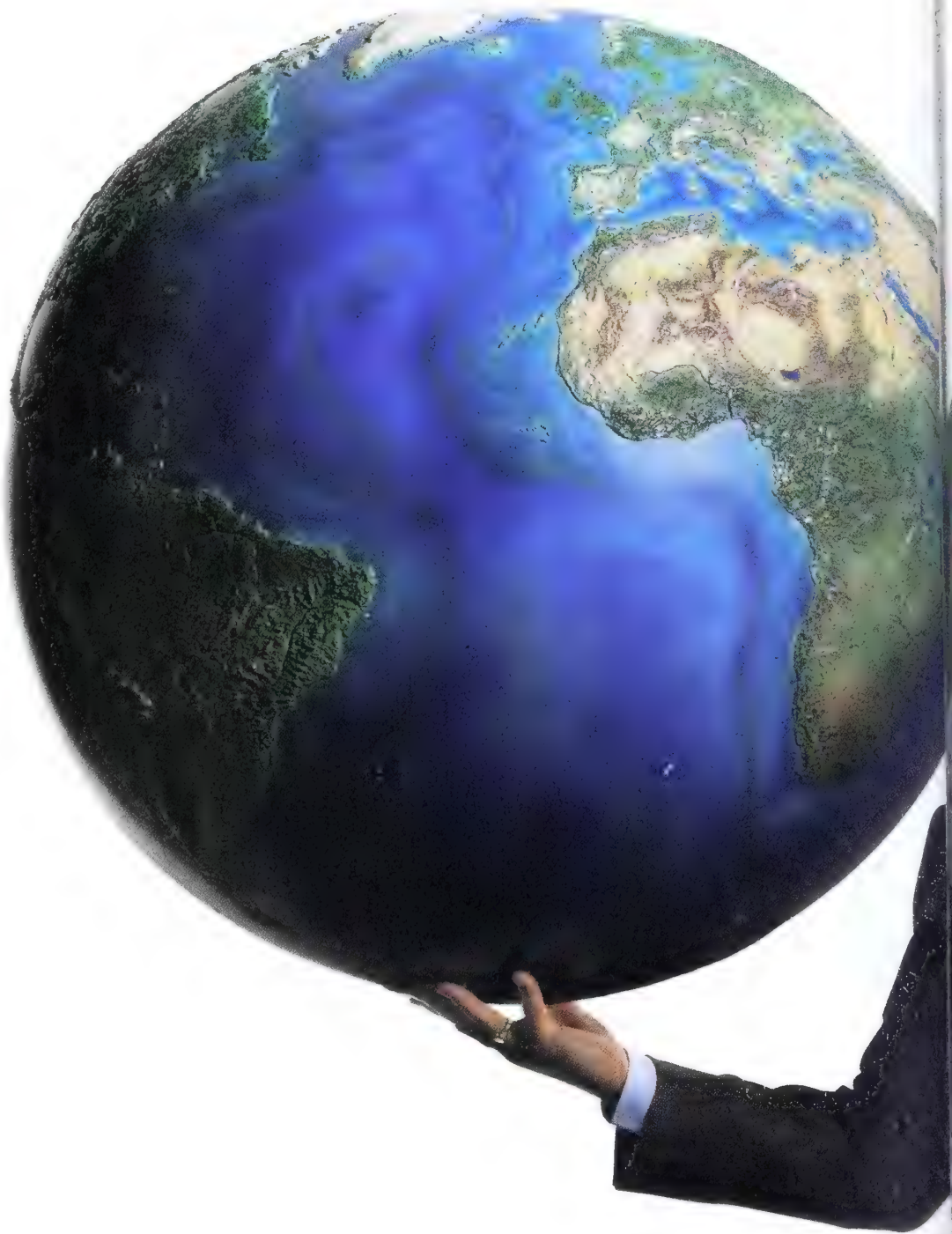
Stewart switched to khaki gear and became so camouflaged that she got lost halfway up. When they regrouped, the women began talking about how to turn Martha Stewart's disparate initiatives into an all-encompassing brand. By late 1995, Patrick was practically living at Stewart's Westport (Conn.) home. "I was working through the night around the kitchen table, trying to figure out how to pull her empire together," she says. Independent of her relationship with Time Warner, Stewart had dozens of other deals for additional books, TV, and new product lines. The business was so scattered and inefficient that 10 banks refused to lend the women money without getting significant equity. So Patrick renegotiated all of Stewart's contracts, securing advance payments. She even kicked in money of her own to become a minority shareholder.

WALLPAPER TO WHISKS. Among the most crucial deals was one with Kmart Corp., which Patrick persuaded to fork over giant up-front payments and royalties and to build "Martha World" boutiques in prime space. In return, the retailer wanted Stewart's signature on sheets and towels in the burgundy and hunter green she detests. "Sharon helped me convince Martha that this is what the mass market wants," says Steve Riman, a Kmart vice-president.

The result? After floundering for nine years, the relationship is finally paying off. Kmart's Stewart-related revenues will hit \$500 million this year—far beyond expectations. With new lines of cooking, gardening, and decorating merchandise—from wallpaper to whisks—on the way, Riman says Martha Stewart will account for 70% of Kmart's \$2 billion housewares business by 2000. By then, says Patrick, shares of Martha Stewart Living Omnimedia will probably be public and revenues will be reaching \$1 billion. So who cares if she doesn't know a scarab beetle from a june bug?

By I. Jeanne Dugan in New York

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Transactions in the Age of the Consumer

Greg Meekings, Managing Director,
Corporate Technology Group, Reuters.



I'LL TRADE YOU: Clinton may allow a capital-gains cut...



...and the GOP may accept a break for low-wage workers

TAXES

WHAT A TAX-CUT DEAL WILL LOOK LIKE

Forget the bluster. A compromise seems likely by August

Call it the war of the soccer moms. On July 10, the Democrats trotted out Gloria Pressley of Gaithersburg, Md., a single mother of two who earns \$24,000 a year and will pay \$1,836 in Social Security taxes this year. Under the House Republicans' tax-cut proposal, they fumed, she'd get back not a dime. That's because she qualifies for a credit that erases her income-tax liability. Under President Clinton's plan, though, she'd collect \$1,000.

Not to be outdone, House Republicans on July 15 introduced their own poster girl—Debra Wilson, a divorced mother of three from Dale City, Va. An accountant making \$62,400 in salary, Wilson would get tax breaks of \$800 in 1998 and \$1,000 in 1999 under the House GOP plan—but nothing under Clinton's because her income level is too high. The Republicans littered the Capitol lawn with items she could buy with her GOP windfall: everything from groceries and a blender to—what else?—a soccer ball.

Working women such as Pressley and Wilson have become ammo in the fierce tax-cut battle over whose plan is fairest to average Americans. Clinton accuses the Republicans of raiding the Treasury for the rich; the GOP claims he is using the tax code to issue new welfare checks.

But even as they exchange broad-

sides, both parties see the outlines of a final accord to cut taxes by \$135 billion through 2002. Barring a rebellion by the Republican right, Clinton could sign the measure—the first tax cut in 16 years—before Congress heads home for its August vacation. “A deal is in the making,” says Representative Robert T. Matsui (D-Calif.). Agrees a senior House GOP aide: “It’s remarkable

DUELING DATA

By using different data, Hill Republicans and the Administration arrive at very different views of the impact of tax cuts. The GOP claims that 53.2% of its tax cuts would go to the middle 60% of taxpayers; the Clintonites say the House bill gives the middle 60% only 32.1% of the cuts.

HOUSEHOLD INCOME*	WHO BENEFITS MOST	
	HOUSE	ADMINISTRATION
UP TO \$12,261	0.2%	0.6%
\$12,262 - \$24,244	4.9%	2.5%
\$24,245 - \$39,356	18.4%	9.6%
\$39,357 - \$63,941	29.9%	20.0%
MORE THAN \$63,941	46.6%	66.8%

*Based on the Joint Committee on Taxation's measure of expanded income, which includes compensation, investment returns, and some fringe benefits

DATA: HOUSE WAYS & MEANS COMMITTEE, TREASURY DEPT.

how close we are. The will is there.

Indeed, both sides have compelling reasons to seal an agreement. GOP lawmakers want to go home and boast they've enacted the “crown jewel” of their Contract With America. They fear the public's wrath if negotiations collapse and Democrats again succeed in tarring them as extremists who prefer confrontation to compromise. And Clinton is eager to fulfill his 1992 pledge to provide middle-class tax relief, hijack a potent GOP issue, and erase the Democratic image as the tax-and-spend crowd.

GIVE AND TAKE. What are the key points of compromise? For starters, Clinton will swallow a broad-based capital-gains tax cut, possibly to a rate of 20%, as long as House Republicans ditch their cherished goal of indexing gains for inflation. In trade-off GOP negotiators are ready to make. The White House also will go along with GOP plans to create expanded individual retirement accounts, but it will insist on setting income-eligibility limits.

Administration officials say Clinton is prepared to accept the broader estate-tax relief sought by the GOP and give up his proposal to target aid to small companies and family farmers. One solution under discussion: embrace the Republican plan to raise the estate-tax exemption to \$2 million from the current \$600,000 over 10 years but phase it in more slowly. Says a top Clintonite: “You’ve got to let the Republicans characterize it as a victory. Then they can all go home and be proud and hold their heads high.”

For its part, the GOP will move much closer to the \$35 billion in education tax incentives demanded by the President. And Republicans are likely to concede to Clinton's desire to lower the \$110,000 family-income ceiling for receiving a \$500-per-child tax credit. “Nobody wants to get blamed for bringing the deal down,” gripes a hesitant compromiser. “Some people are willing

ve away the store to get a deal." nagging issue remaining is Clinton demand that the child tax credit be able to low-earning families even if they owe no income tax. Republicans say that if you don't pay income tax, you don't deserve a rebate. Clinton says that many of the working poor pay thousands of dollars per family in Social Security taxes. The White House signaled a willingness to consider compromises such as a \$250 credit for families that don't owe income taxes. House Speaker Newt Gingrich, who earlier labeling the proposal "well-intentioned" on July 15 that he, too, is seeking a middle ground to find tax relief for lower-income workers.

TOLL. The reason for the retreat: success of the Democrats' class-war rhetoric. Republicans acknowledge the steady drumbeat of attacks has taken a toll. Recent polls show that most people believe the GOP tax cuts are a gift to the wealthy while Democratic proposals will bring more tax relief to the middle class. "We're losing," laments Republican Governor Tommy Thompson of Wisconsin. "There's no question that Democrats are better at rumor-mongering and getting their message out."

Clinton has made Republicans defensive—and ready to deal. GOP leaders say they'll get clobbered if they take a hard line. They're still smarting from disastrous miscalculations over the 1996 government shutdown and the failure of the flood-relief bill. In both showdowns, the President sent the GOP limping off the PR battlefield. "If Clinton decides to veto [the tax-cut bill], he'll hurt us," says a Hill Republican. "So we go out of our way to avoid a veto." Clinton's leadership's willingness to trade could spark a mutiny among 30 GOP hardliners. Many of these lawmakers thought the original House bill didn't cut taxes deeply enough, and they mightily resist further concessions. "There has to be a time to draw a line in the sand," says Representative Salmon (R-Ariz.). Reining in the President will be a key test for the emboldened Speaker, but veteran Hill-watchers predict he'll prevail. Conservatives grouse a bit, but most will go along, says Michael P. Andrews, a political analyst for Salomon Brothers Inc. Even if the firebrands succeeded, the prospect of victory would be bitter: Clinton might retain veto power to veto a hardline tax bill, Republicans would take a political beating without winning any concessions. That's why all the photo ops with Clinton and his moms won't change one key thing: Republicans are likely to take the deal they can get.

by Richard S. Dunham and Amy L. Dunham in Washington

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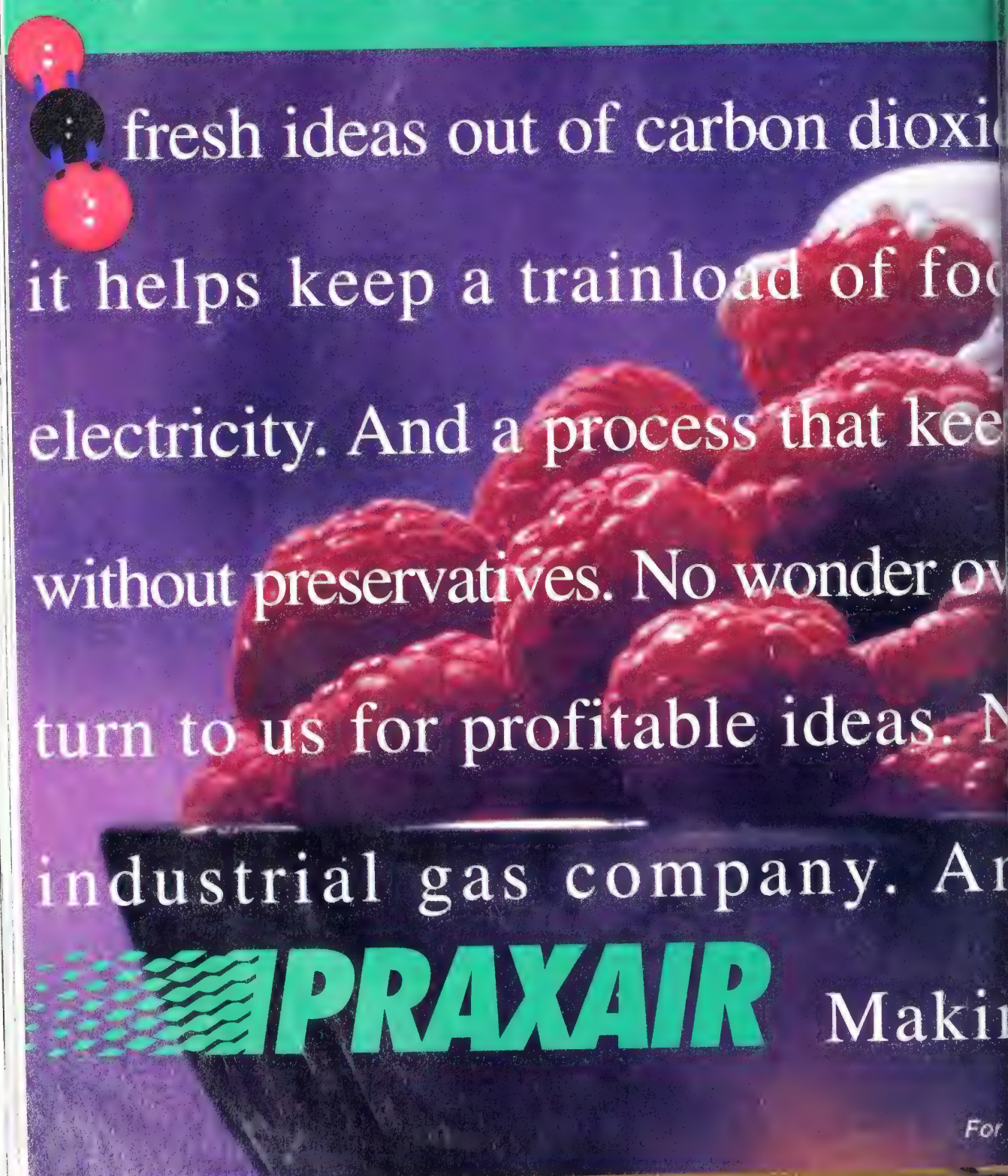
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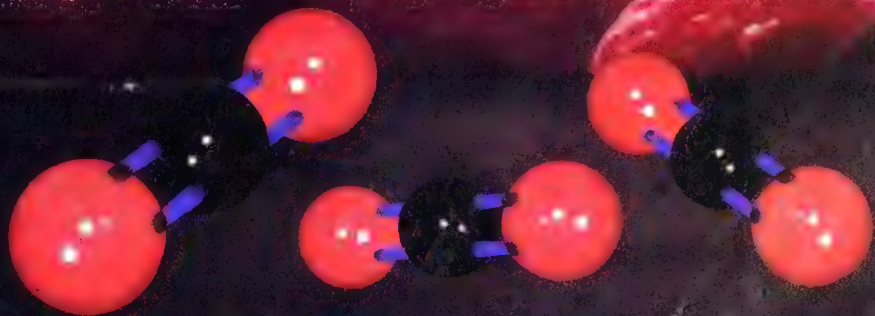
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onder, too, we're a \$4.4 billion
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ur planet more productive.



THE CURRENCY CRISIS SWEEPING SOUTHEAST ASIA

Devaluations in one country after another may rein in growth

For Philippine businessman Lawrence C. Qua, the news that came on July 11 could hardly have been better. Qua, the president of Manila-based Ionics Circuits Inc., had just heard that his country's central bank had followed Thailand's recent currency devaluation and allowed the peso to fall 10%. Dire tidings for most, but Qua was beaming. Ionics, an exporter of electronic components, earns all of its revenues in U.S. dollars, which now will go a lot further toward paying workers and meeting other costs at home. "The more depreciation, the better it is for us," says Qua. "We'll have a windfall."

Across town, in Manila's Makati business district, Raul T. Concepcion faces a grimmer future. "I'm worried," says the chairman of privately held Concepcion Industries Inc., which manufactures air conditioners and refrigerators for the domestic market. "Power rates and oil prices will go up." And labor groups are already demanding that business leaders increase wages in response. "The gains from devaluation will be lost," frets Concepcion, president of the Federation of Philippine Industries. "We'll be back to square one."

EASY TARGET. Qua and Concepcion are two of the winners and losers in the currency turmoil sweeping Southeast Asia (table). Having helped force an 18% devaluation of the Thai baht on July 2, currency speculators turned on neighboring countries with exchange rates linked to the U.S. dollar. The Philippines, armed with tiny foreign-exchange reserves and an economy only just recovering from years of torpor, was an easy target. Manila tried to resist the onslaught before giving in on July 11. Then came Malaysia, where the central bank jacked up interest rates to 50% and spent an estimated \$1 billion before surrendering on July 14. The ringgit promptly plunged to a 33-month low. Lamented Finance Minister Anwar Ibrahim: "There's a limit to what we can do."

Even some of the region's more predictable currencies have not been immune. Indonesia's rupiah fell to a record low of 2,471 to the U.S. dollar and could weaken further. And despite rising local interest rates, the Singapore dollar might be next, especially since the economy has not recovered from last year's slowdown. Singapore's stock market has already fallen 16% this year. "Nobody is safe," warns John B. Seel, economist with Bear Stearns Asia in Hong Kong.

The Asian meltdown is the latest in a string of competitive devaluations that have rocked global currency markets for five years. Back in 1992 and '93, the European exchange-rate system blew out as ally after ally couldn't keep pace with Germany and its strong mark. When Britain dropped out of the system, a painful chain of devaluations from Sweden to Italy ensued. Then, in 1994, Mexico was forced to devalue the peso sharply against the dollar after a wave of capital flight

THE PHILIPPINES

Money changers are doing a brisk business as the government expects inflation, now 4.6%, to nearly double

demonstrated that its economy was no match for the stronger U.S. after passage of the North American Free Trade Agreement. More recently, the Czech Republic has also seen its currency collapse as its trade deficit has mounted. The turmoil has even touched Brazil. Its booming stock market plunged 7% in



mid-July amid fears that the Brazilian real would be the next currency to fall.

Southeast Asia's situation is more acute. The region does have one major strength: some of the world's highest growth, savings, and investment rates. But like the Latins, Asians had binged on easy-money policies. Now, the Asians—like the Europeans, Mexicans and even the Japanese—are paying the

They are also being forced to "be more realistic about steps they to take to keep their economies healthy in the longer term," says DRI/Haw-Hill Asian economist Devi Au-Central banks will have to reassert control over monetary policies to maintain credibility. And governments will have to reform everything from capital controls to industrial planning to avoid a beggar-thy-neighbor devaluations. **A'S EDGE.** For now, however, the answer will be to rely on cheap currencies to deliver export growth. As the world's strongest economy, the U.S. will be the market of choice for Southeast Asians hoping to get their way back to health. Soaring

the region was \$5.8 billion by the end of the first half of 1997, according to the Japan External Trade Organization.

How Tokyo handles this crisis in countries where memories of Japan's brutal World War II occupation are still strong will test its ability to take an international leadership role. So all eyes were on Thailand's new finance minister, Thanong Bidaya, as he made his way to Tokyo to meet with Japanese Finance Minister Hiroshi Mitsuoka and Vice-Minister for International Affairs Eisuke Sakakibara on July 18. Just three days earlier, Mitsuoka said Japan, if necessary, would join forces with the International Monetary Fund to salvage the tumbling Thai baht and other Asian currencies.

rising trade deficits, a glut of factories, and stiffening competition from China.

Indeed, Chinese manufacturers—bolstered by an artificially low renminbi—are squeezing out Southeast Asian producers of garments, electric appliances, and telecommunications gear. At the same time, the emerging Tigers are having trouble competing with South Korea and the former Soviet states in heavy industries such as steel and petrochemicals. Japan, too, is adding to the region's worries. Morgan Stanley, Dean Witter, Discover & Co. analyst Alexander Kinmont observes that Japanese manufacturers "added productive capacity equal to that of France" at home in the 1980s, then built an equiv-



THE TURMOIL SPREADS ACROSS SOUTHEAST ASIA

THAILAND Banking problems, flagging exports, and a current-account deficit force the Thais to devalue the baht by 23%. Stocks are down 25% in dollars in 1997.

MALAYSIA The central bank stops propping up the currency on July 14 and sees it fall by more than 4%. Stocks are off 21%.

SINGAPORE With the economy slowly on the mend from last year's slump, even the Singapore dollar—a traditional safe haven in the region—is under pressure. Earnings growth should fall in 1997. Stocks have dropped 16%.

INDONESIA The rupiah briefly plunges to a record low against the dollar, although the country is cited as a model of flexible currency management in the region. Stocks are still up 9%.

PHILIPPINES With few resources to fight back, Manila devalues the peso by 4%. It rebounds a bit, but domestic demand will suffer. Companies facing stiff competition and rising import costs will see earnings dwindle. Stocks are down 22%.

DATA BUSINESS WEEK

theast Asian exports may set off storms from Washington. But the country with an even bigger stake in Asia's economic mess is Japan.

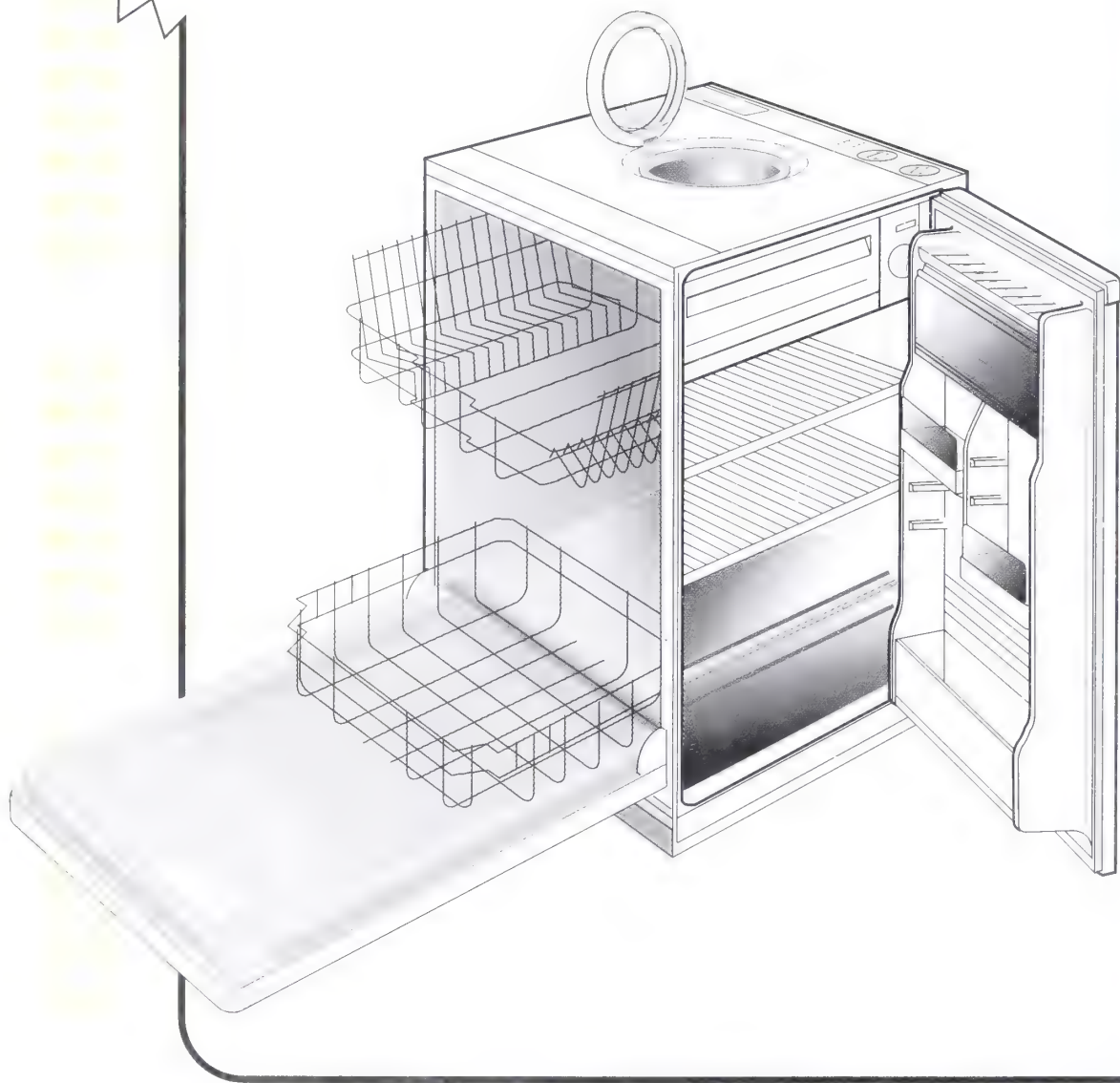
Japanese banks are the biggest lenders to Southeast Asia—ING Barings analyst James Phillip Fiorillo figures they have an exposure of roughly \$100 billion. Japanese manufacturers are the region's biggest investors; Japanese direct foreign investment into

Asia's money meltdown is testing the foundations of an export-led economic model that has delivered years of spectacular growth. But more than a decade of strong exports of semiconductors and other goods blinded policymakers—and the currency market—to the shortcomings of the system that Southeast Asians have used to fuel economic growth. These include stressed-out banks, overheated property markets,

excess amount of capacity overseas in the next decade. Much of that investment was made in Asian low-cost plants.

These factories and others will become even more competitive in world markets now that Asian currencies have fallen. But there is a trade-off. In the Philippines, Central bank governor Gabriel C. Singson says the recent interest-rate hike to 32% is a "temporary measure," but he expects inflation, now

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-
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4.6%, to double. Many companies will find it difficult to pass along the increased costs to consumers, says Victor S. Limlingan, professor at the Asian Institute of Management in Manila.

Malaysia, too, has problems. The central bank has been trying to cool off the real estate market for months, but analysts still expect a property glut next year. The current-account deficit is inching up and will hit a dangerous 6% of gross domestic product this year. As direct investment tapers off, Malaysians have become more reliant on unstable short-term debt.

Back in Thailand, where everything started, manufacturers are batten down. Toyota Motor Corp., for one, is considering raising the prices on vehicles sold in Thailand to compensate for currency losses. In fact, the devaluation couldn't have come at a worse time for Toyota, which plans to increase capacity in Thailand by 20% by early 1998. General Motors Corp., which is building a new plant in Thailand, will benefit from devaluation, since 80% of its output will be exported, says CFO J. Michael Losh.

Throughout Southeast Asia, recovery will be hindered by the weakness of the banking system (BW—Feb. 24). Unless policymakers quickly establish ways for banks to securitize bad debts and unload them, governments may end up devoting scarce resources to bailouts. And banks will have less ability to lend to startups that create jobs and growth. **"TIME WARP."** Tight control over exchange-rate policy, which hasn't kept up with the region's growth, must be relinquished. In the first half of the decade, protectionist policies insulated currencies from market forces. Determined to help exporters, governments resisted pressure for currencies to appreciate against the dollar despite billions in capital flowing into the region. "Central banks were sitting in a time warp," says Rajeev Malik, senior economist for Jardine Fleming International Securities in Singapore. "With undervalued currencies and high interest rates, there was a double incentive for money to come in."

The game worked until 1995, when Washington and Tokyo reached an agreement to devalue the record-high

yen and fortify the greenback. As the dollar strengthened, it carried the Southeast Asian currencies along with it. But most countries "didn't immediately see that they should make some changes in their management of exchange rates," says Asia Development Bank senior economist V. V. Desai. Not

SINGAPORE

The stock market has fallen as worries mount over new threats to the economy



THAILAND

Toyota may have to hike the price of these Thai-built pickup trucks to offset currency losses

only was the region suffering from overcapacity, but many countries had become reliant on short-term debt to finance huge imports of capital equipment and other items for government infrastructure projects. As a result, says Malik, short-term debt now accounts for about 25% of the region's total.

Not every Asian country mismanaged its currency. Hong Kong has a firm tie between its dollar and the U.S. greenback. Hong Kong boasts strong banks, a current-account surplus, and a commitment from Beijing to put its billions in

hard currencies behind Hong Kong's huge reserves. Indonesia has taken a different tack. It kept speculators at bay by letting the rupiah depreciate gradually. On July 11, it widened the band within which the rupiah trades, letting it hit a record low against the dollar. But even a flexible currency policy hasn't saved Indonesia from some of the woes typical of the region. With real GDP growth expected to hit 7.8% this year, the current-account deficit has widened to 3% of GDP from 3.5% last year.

Government officials are looking around the region for other tools at their disposal to limit the damage from the current run. Traditionally, they have ordered tight fiscal policies, without large budget deficits. Exports in the bellwether electronics sector should pick up as demand increases in the West. That's especially true for Singapore, where such U.S. electronics giants as Motorola, Texas Instruments, and Hewlett-Packard are seeing demand for their products surge.

The crisis should also force governments to be realistic about growth. They'll have to develop financial markets to let banks securitize property losses or companies hedge foreign currency. More important, leaders must "find new ways to power their economies, since labor and capital are no longer as cheap as they used to be," observes DRI/McGraw-Hill's Aurora.

Asians also will need to introduce more appropriate exchange-rate policies to reflect market forces and prevent spending binges that have to be financed with short-term debt. "The moral of the story is to stay within your means," says Gan Veng Beng, executive director of Commerce International Merchant Bank in Kuala Lumpur. If not, he adds, "the financial markets will force it on you." After the events of this month, that is a lesson that Southeast Asians should have had time forgetting.

By Bruce Einhorn in Manila, with Michael Shari in Jakarta, Mark L. Clifford in Kuala Lumpur, Brian Bremner in Tokyo, Hugh Filman in Manila, and Kerry Capell in New York

COMMENTARY

By Peter Coy

WHY FOREIGN CAPITAL WON'T DRY UP

Japanese Prime Minister Ryutaro Hashimoto scared the daylights out of Wall Street on June 23. At a Columbia University luncheon, he seemed to warn that the Japanese might sell their U.S. Treasury bills unless the U.S. helped stabilize currency exchange rates. The Dow Jones industrial average sank 192 points.

Aides to Hashimoto rushed to say that he had not meant to issue such a threat, and the stock market recovered in later sessions. Still, its stumble showed how nervous investors are about the U.S. economy's growing reliance on foreign capital—especially government capital.

REAL, LIVE ISSUE. The nervousness is understandable. Foreign governments now hold 17% of U.S. Treasury debt, up from 10% in 1987. In 1996, they added \$122 billion to their holdings of U.S. Treasuries and other domestic securities, more than this year's entire federal budget deficit. If they pulled out, the dollar could fall and interest rates would rise. Traders point out that the Treasury Dept.'s custody account, which holds U.S. securities on behalf of foreign central banks, has shrunk 50%, to \$628 billion, since April, after nearly doubling in size since 1993. This is a real, live issue for the markets," warns Ian Shepherdson,



CHICAGO CURRENCY PIT: Low inflation gives the dollar allure

chief economist of HSBC Markets Inc.

But the odds are that foreign governments will find it both politically and economically unwise to pull back. If anything, their huge role in financing the U.S. deficit is a positive sign, because government money is less flighty than private money. No government—least of all Japan's—wants to start a run on the dollar or Treasuries. That would only derail the U.S. economy, which remains the engine of world growth. Besides, the dollar is attractive because of relatively high interest rates, low inflation, and the fact that the U.S. budget and trade deficits are smaller now as a share of the economy than in the 1980s. Europe's woes with monetary union in recent months, coupled with devaluations in Thailand and the Philippines, have made

the dollar more of a refuge than ever.

The charts below show who is financing the widening deficit in the U.S. current account—the broadest measure of trade in goods, services, and investment income. When dollars flow abroad, foreigners have to invest them in something, whether it's stocks, real estate, or Treasury bills.

BIG BUYER. What's surprising is how much of that capital is coming from official sources. The middle chart shows how

much private foreign sources increased their investments in the U.S. each year, minus the amount that U.S. sources hiked investments abroad. The private inflow is too small to cover the deficit.

Enter the governments. In 1996, the net inflow of \$129 billion in official assets was nearly twice the \$67 billion net inflow of private assets, according to the Commerce Dept. Those numbers should add up to the \$148 billion in the current account deficit but don't because of statistical discrepancies.

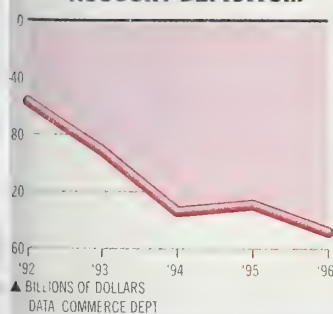
Why are governments playing such a big role? Some may be trying to prop up the value of the U.S. dollar so they can enjoy export-led economic growth. Others may simply regard dollar assets as a good value.

In any case, the money has been pouring in.

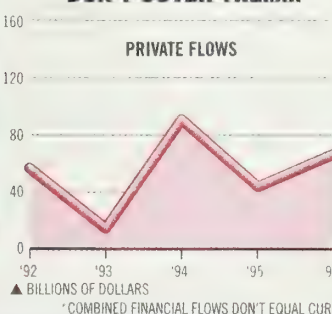
Hashimoto may have spooked Wall Street for a day, but the governments of Japan and other nations are not likely to bail out of the U.S. Treasury market.

Coy is associate economics editor.

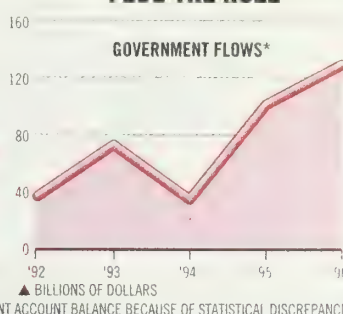
THE U.S. RUNS HUGE CURRENT ACCOUNT DEFICITS...



...AND PRIVATE INVESTMENTS DON'T COVER THEM...



...SO FOREIGN GOVERNMENTS PLUG THE HOLE



* COMBINED FINANCIAL FLOWS DON'T EQUAL CURRENT ACCOUNT BALANCE BECAUSE OF STATISTICAL DISCREPANCIES

JOY. COURAGE. DISMAY. TENSION.
PAIN. AWE. GALL. PASSION. HORROR.
FRUSTRATION. HOPE. GREED. STRESS.
EXUBERANCE. PRESSURE. GLEE. ANGER.
RAGE. MISERY. DRAMA. FEAR. GRIEF.
SHAME. ENVY. EXCITEMENT. ELATION.
JEALOUSY. DESPAIR. TRUST. DISTRESS.
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BusinessWeek

GENE G. MARCIAL

SECURING DATA— AND GROWTH?

Who do you call when disaster strikes your computer system? As at some blue-chip companies and government agencies call SunGard Data Systems (SDS), a major provider of data-recovery and support services. Lately, the stock has been in a quick

HITTING ON ALL CYLINDERS



SUNGARD
DATA SYSTEMS
WEEKLY CLOSE

FEB. 4, '97 JULY 15
DOLLARS

DATA: BLOOMBERG FINANCIAL MARKETS

recovery of its own, bolting up from 42 a share in late June to 51 in mid-July. The reason: snappy sales and earnings growth.

Some pros, including Merrill Lynch's Stephen McClellan, see more: a takeover target. "Management would consider a takeover at the right price," says McClellan,

insists he doesn't know if SunGard received any offers. Based on earnings growth alone, SunGard should hit over the next 12 months, he says.

As one San Francisco money manager who has been buying shares: "It has a market value of \$2.2 billion. 1996 revenues of \$670 million, SunGard is worth 75 in a takeover." It would be an ideal fit for any of the large computer companies, such as Automatic Data Processing or Electronic Data Systems, he adds.

Merrill's McClellan is impressed by SunGard's leading market position in financial-investment software and computer-disaster recovery services. It's "hitting on all cylinders, with revenue expansion in its mainstream computer services well above 20%," he says.

SunGard provides solutions to two pressing business needs: data processing support to the investment community and data-recovery systems for companies that suffer disruptions from disasters as earthquakes, floods, or power failures. The company maintains multiple data processing sites, including mobile units, for customers caught in emergencies.

SunGard, observes McClellan, "has a solid customer base, high [busi-

ness] retention level, strong cash flow and finances, and an accretive acquisition strategy." Customers include Chase Manhattan and Citicorp. Some 80% of revenues is on a recurring basis and, he notes, margins are "trending upward." The consolidation in the banking industry, he says, has been a boon to SunGard. "It benefits from the proliferation of financial and investment instruments and from the big mergers going on." McClellan expects the company to earn \$1.90 a share in 1997 and \$2.27 in 1998, vs. 1996's \$1.59.

GOOD CONDITIONS AT VAIL

Like buying spring hats in the winter, big-name investors are snapping up shares of the largest ski complex in North America in the summer. Not that skiers are flocking to resorts in greater numbers. On the contrary. The total number of "skier days" during the 1996-97 season slumped 2.8%, to 52 million, from a year ago. But the pros like Vail Resorts—where visits to its four premier resorts jumped 5%.

"It will be even more of a blockbuster next year for Vail," says investment manager Ron Baron, president of Baron Asset fund, which has a 13% stake in Vail. The stock, priced at 22 when Vail Resorts went public in February and now trading at 25, is undervalued, based on the company's huge growth potential, says Baron.

He notes that Vail's new chairman and CEO, Adam Aron, tripled the sale of season passes to Colorado residents in his first year at Vail. Aron is "an award-winning, top marketing executive with senior experience" at Hyatt Hotels, United Airlines, and Norwegian Cruise Lines, says Baron. The company, which operates Vail Mountain and Beaver Creek, a family-oriented resort, acquired three other resorts this year: Breckenridge, Keystone, and Arapahoe Basin.

CEO Aron plans to spend \$74 million in 1997 to improve and expand

the facilities. The expenditures will not only increase skier volume but pump up revenues at its retail and restaurant facilities, says Jason Ader, entertainment analyst at Bear Stearns.

Ader figures cash flow will grow to \$88 million in 1997 and to \$100 million in 1998, up from 1996's \$72 million. His near-term target for Vail: 31.

FRUIT AND VEGGIE LIFE SUPPORT

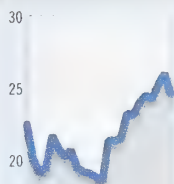
How do you keep newly cut fruits and vegetables fresh for several days or even weeks? Some investors think EPL Technologies (EPTG) has the answer, and they've been scooping up shares of the little-known company. The stock, trading at 4 in late April, has been on the rise and hit 6 1/4 on July 15. The company says its food-processing technology helps extend the shelf life of produce by inhibiting the enzymatic browning and subsequent degradation of cut fruits and veggies.

"If it proves to be true, there will be a huge worldwide demand for EPL's technology," says Harvey Eisen, senior vice-president for investments at Travelers Group. So far, it's all speculative, he adds. The proof will be in the contracts that EPL should attract, he adds.

Some money managers contend that EPL expects to soon sign a contract with a major food-processing company. A year ago, the company had signed a letter of intent with Pillsbury for a joint venture to use EPL's proprietary organic acid-based processing solution in potatoes. So far, nothing has come out of the pact, but some think a contract is forthcoming.

Another believer in the product is Amanda Bernardi, an analyst at Hermitage Capital, a New York investment firm that has accumulated shares. EPL's technology covers eight produce categories, including potatoes, apples, and onions. Bernardi, who expects the company to show a loss this year on estimated sales of \$21 million, figures EPL will earn 55¢ in 1998 on sales of \$62 million.

STEADY CLIMB

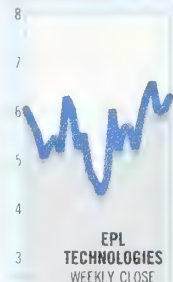


VAIL
RESORTS
WEEKLY CLOSE

FEB. 4, '97 JULY 15
DOLLARS

DATA: BLOOMBERG FINANCIAL MARKETS

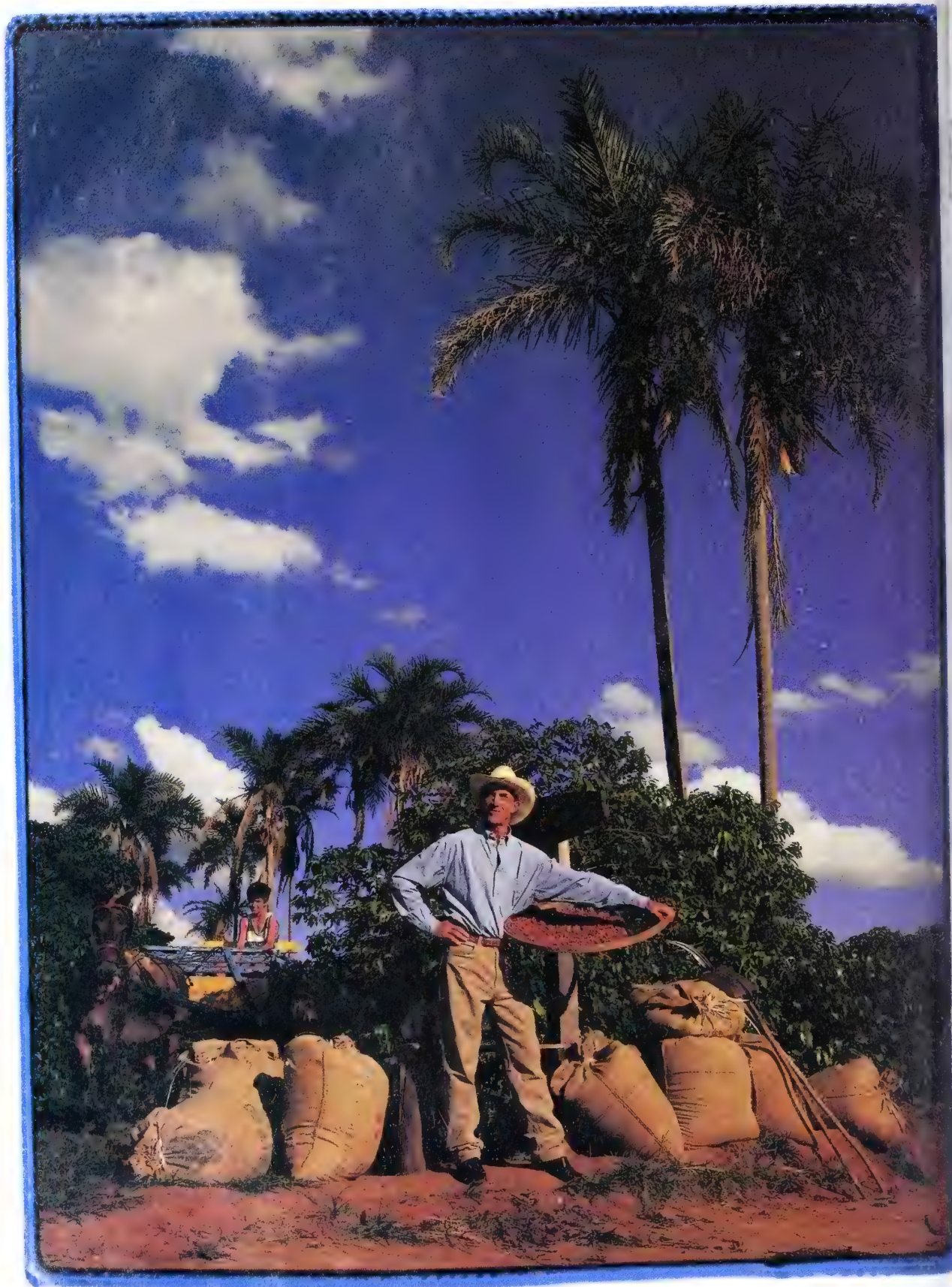
A FRESH LOOK



EPL
TECHNOLOGIES
WEEKLY CLOSE

JAN. 20, '97 JULY 15
DOLLARS

DATA: BLOOMBERG FINANCIAL MARKETS



THE PEOPLE OF BRAZIL PRODUCE THE WORLD'S BEST COFFEE

And soon

COME OTHER GREAT
WAYS TO GET
TO WORK IN THE
MORNING

In Brazil, people will tell you proudly that their country's home-grown coffees are the best the world has to offer. They say that when you sip a cup of their 'cafezinho,' you take inside some of the spirit of their country.

Brazilians may also tell you about some other homegrown products

Toyota Corolla



soon to be built in Brazil

that stir local emotions. The Toyota trucks, built locally since 1959, and Corollas, soon to be manufactured in a new plant in São Paulo.

As a company operating in the global marketplace, Toyota recognized early the need to invest in local design, research and manufacturing, to ensure that the products we sell answer the special needs and standards of all of our customers.

That's why, today, in 26 countries around the world, Toyota vehicles are being built by the people who drive them.

Our global commitment goes beyond economic investment. From educational programs in Kenya, to environmental work in Australia and South America, the people of Toyota are giving back to the communities where they live.

Here in the U.S., Toyotas are designed in California, built in Kentucky and California, and tested in a multi-million-dollar facility in the Arizona desert.

In communities around the world, Toyota is more than just a source of local transport - it's a source of local pride.

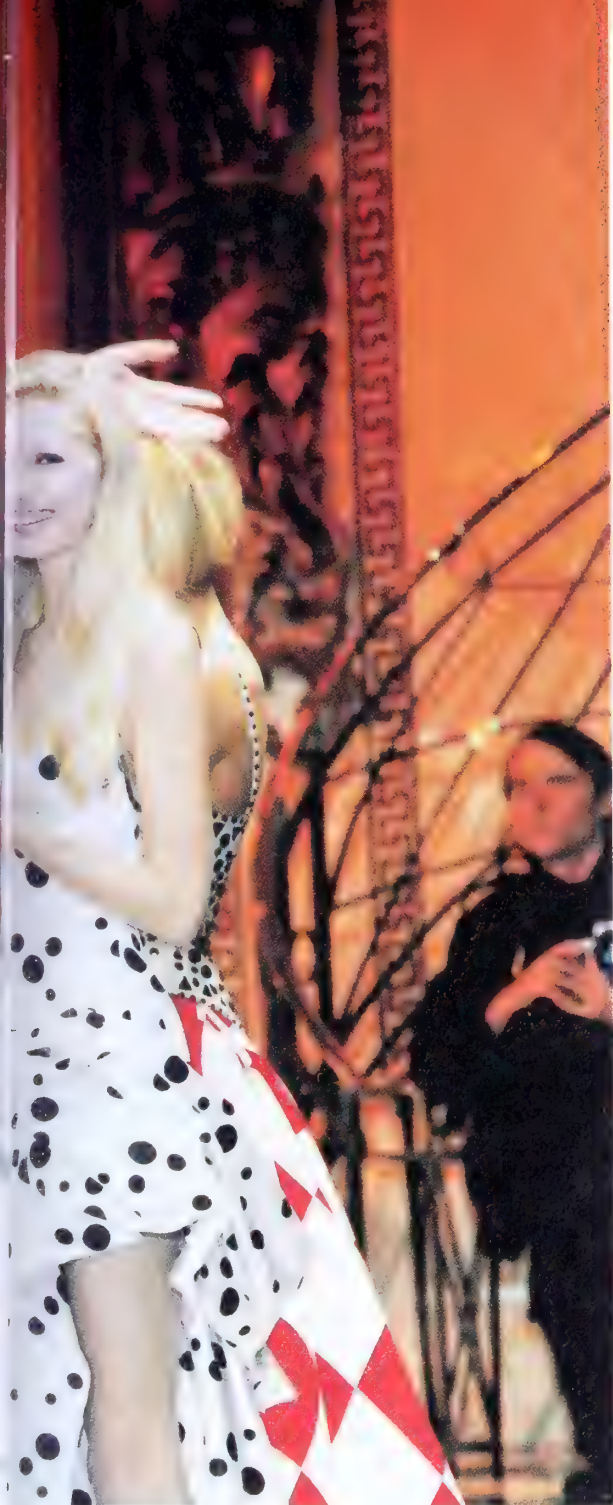
TOYOTA People Drive Us



Cover Story

AFTER VERSACE

Can a fashion empire survive the slaying of its creative soul?



ong past midnight Gianni Versace blew a kiss to a French starlet. "*Ciao carissima, ciao bella,*" the 50-year-old designer said as he worked the pulsating crowd in Milan's cavernous Café L'Atlantique discotheque. Versace had rented the high-tech nightclub scores of models, friends, fashion buyers, and jet-setters to celebrate his Spring 1998 ready-to-wear collection. British p star Boy George, one of Gianni's countless rock-and-roll ends, had even been flown down first-class from London to disc jockey for the evening, a job he did with abandon undawn.

It was pure Versace, as classic as his trademark \$15,000 wns worn by global glitterati from Princess Di to Madon-



THEN AND NOW

Versace triumphant after a 1995 show.

The gates of his Miami Beach estate where he was shot down

na. The next morning at 8.30 a.m. he was back at his desk in the 18th-century palazzo in central Milan, once the home of the Rizzoli publishing dynasty, that served him both as home and corporate headquarters. From there he was driving the \$1 billion fashion empire he owned and ran with elder

brother Santo and sister Donatella toward its next planned triumph: an initial public offering of the glamour stock, putting a price tag of up to \$1.5 billion on the family company Gianni Versace.

No longer. Gianni was murdered on July 15 at the gates of his \$6.2 million Miami Beach estate, Casa Casuarina, where he had recently partied with Madonna. Two bullets to the head at point-blank range killed the hard-living, hard-working king of global chic as he returned from an early morning walk to the nearby News Cafe newstand. He died as he had lived, the center of media attention as hordes of journalists flocked to Miami Beach. But as Gianni collapsed, so did the hopes and dreams he and his family had long nurtured.

For months, everything had been meticulously readied to

transform the one-man fashion whirlwind into a global brand wrapped in a publicly traded company that could outlive its mercurial creator. The final step was imminent. As Versace died in far-off Miami, and alleged serial killer Andrew P. Cunanan was being named as a suspect, bankers from top-drawer U.S. investment banks—Morgan Stanley, Merrill Lynch, and Goldman Sachs—sweated it out in Milan's blistering heat. They were expecting to discover on July 18 who would be picked to underwrite what was shaping up as one of Europe's hottest stock offerings in 1998.

Now the IPO is suspended as the family

Life of a Designer

BORN Reggio Calabria 1946

TRAINING Apprenticed at mother Franca's seamstress business in Reggio

EARLY CAREER Moves to Milan in 1972 as contract designer and in 1978 brings out first collection under own name. In early 1980s, begins close links with rock 'n' roll and entertainment worlds

FAMILY COMPANY Gianni Versace, 50% owned by Gianni, 30% brother Santo, and 20% sister Donatella

STRATEGY Establish Versace as a strong global brand, branch out into nonfashion lines like home accessories, and double sales by 2000

and the fashion world mourn. In financial markets, the question already is: Can Versace, with its vast international web of retail outlets and manufacturing companies, survive the slaying of its creative soul? And if it does survive, what would a post-Versace Versace look like?

There are grounds for optimism. Much of the product design at Versace was handled not by Gianni, but by a strong team of

Cover Story

Italian, American, Korean, and French assistants. The best, said Gianni, earned \$15,000 a month after tax. When Gianni was recovering throughout 1994 and 1995 from chemotherapy for a rare inner-ear cancer, the team churned out collections seamlessly. In the future, say insiders, Versace will have to turn to a charismatic new designer as did Gucci, which reversed its slide by hiring American Tom Ford in 1994.

"IMAGE THING." Still, no other major fashion house in the world is so closely identified with the lifestyle of its marquee-name designer. Even the suave Giorgio Armani, Versace's longtime rival for supremacy in the Italian fashion world, is a shrinking violet in comparison. From partying with his friend Sting to lunching with Princess Di, Gianni stole headlines, shocked the world with his sexy gowns, and drew in hordes of paying customers to his boutiques. Now, worry fashion business insiders, the damage to the business could be immeasurable if that glamorous image is shattered by unsavory revelations about Gianni, of possible financial misconduct, or even an association with his assassin. Already, the Versaces won substantial damages and a retraction after suing the *Independent on Sunday* for libel. The British paper had run an article claiming the fashion house had links to the mob. And Santo Versace is currently appealing a conviction in May for bribing Italian tax officials.

With the IPO approaching, Gianni himself had been playing down his role as the fashion world's most legendary party animal. "It's a moment [for me] to appear less and focus more on the product," said Gianni shortly before his murder. "This whole image thing belongs to the past."

Dropping the glitz and going for

more sober-sided fashion, surprisingly, had been paying off at the cash register. His recent collections, with their cleaner and cooler lines, have been hotter than ever, says a big buyer, Saks Fifth Avenue President Rose Marie Bravo. Helping push sales: 10% to 15% price cuts on most Versace items from late last year.

Still, the transformation was hard on Gianni. Elder brother Santo, a down-to-earth number-cruncher and tough negotiator, had to force him to cap frenetic spending on art and trophy real estate in Europe and the U.S. Several months ago, say insiders, Santo even had Gianni's credit card quietly taken away, while the designer was rumored to have a growing pile of personal debt.

Gianni was complying by cutting back on some of the wilder excesses that a \$70 million annual promotion budget could buy. "I want [the company] to be perfect when we go to the market," Gianni told *BUSINESS WEEK* in June.

The family was well into the detail work needed to get there. Just three weeks before Gianni's death, they split off \$100 million worth of personal assets—including the Florida mansion, a lavish Manhattan townhouse complete with a massive bed from artist Julian Schnabel, and a museum packed with Picassos, Légers, and other masters—from the core fashion businesses.

But the Versaces were surfing a far bigger wave than even their own vast ambitions. From São Paulo to Hong Kong, and Beijing to Houston, *la moda italiana* is sizzling. Even without a Versace listing, fashion capital is flowing into the sector as never before. Last year, Italy clocked \$15 billion in fashionable exports, vs. less than \$3 billion by arch-rival France.

Stock-market fever, in fact, has Italy's booming fashion world in its grip. Rome's Bulgari jeweler went public in July, 1995, to finance global expansion and has seen its stock price soar 45%.

Florence-based Gucci has doubled in value since its NYSE listing in March, and now

IN CROWD

Versace gowns grace glitterati from Madonna to Naomi Campbell



Versace's Global Fashion Business...

SALES: \$1 billion

EMPLOYEES: 1,200

SUBSIDIARIES: Controls 10 of his major suppliers

BOUTIQUES: More than 300 worldwide, the 50 largest are owned by the company, the rest by franchisees. All told, more than 2,000 sales points



...Faces Tough Worldwide Rivals

U.S.: POLO-RALPH LAUREN The school look boosted by \$750 million raised in June IPO; Calvin Klein, now targeting expansion in Europe

ITALY: GIORGIO ARMANI No. 1 in Italy with \$1.2 billion in 1994; may take company public

FRANCE: LVMH'S brands such as Givenchy, Christian Lacroix, and Gucci generate over \$1.8 billion in sales



...rth more than Italian tire and cable giant Pirelli. Romeo
Valentino has contacted Goldman Sachs about a listing
even Armani says he's mulling over taking his fashion
re to the market.

...face the same tough challenge as Versace: Making the
from family-run fashion houses revolving around a single
ner to global, professionally run brands. That's essential
ay on top of the world market for branded luxury goods
that's expanding fast thanks to
the collapse of communism and
super-growth across Asia.

ILY BIZ

...ace ran his
pany with
her Santo (right)
sister Donatella

Versace tuned into the trend
early. Way back in 1986, the close-
ly held company became one of
the first family-owned fashion
groups in Italy to publish fully

DRAWING POWER

The company uses a
squad of young
designers to follow up
on Versace's ideas

Asia. Already the first designer to set up shop in post-com-
munist Russia, Versace had scheduled store openings from
Bombay to New Delhi and Johannesburg.

The competition from bigger and better-equipped U.S.
and French designers, of course, is fiercer than ever. Calvin
Klein Inc., for example, opened a spacious store in central Mil-
lan close to Versace headquarters. And in late May, Klein in-
augurated a tony emporium on Paris' ultrachic Avenue Mon-
taine. Santo Versace picks military lingo to explain: "There's
a daily world war out there between the Italians, the French,
and the Americans."

But Versace had a secret weapon: A nimbleness that LVMH
or Polo-Ralph Lauren could only envy. The Versaces typical-
ly made decisions with lightning speed—a key competitive ad-
vantage in an industry where styles and fads change
overnight. Tuesday mornings, for example, each Versace re-
ceived computer printouts of which Versace items were hot
sellers, and which weren't, at the group's 300 boutiques. Al-
though collections are designed, presold, and manufactured six
months in advance like the rest of the industry, Versace often
pounces with what it calls "flash items" to respond to the
changing marketplace. One such item, \$200 jeans made from
high-tech PVC fiber, was designed, manufactured, and delivered
to boutiques in under five weeks.

ITALIAN ARCHETYPE. Such flexibility is the hallmark of Italy's
best fashion firms. Experts sum it up in a word: family. Clan
capitalism, in which family members work cheek by jowl,
fires the success of the Salvatore Ferragamo shoe empire, the
Ermenegildo Zegna menswear group, and countless other
Italian outfits as well as Versace. "You just don't have that in
France or the U.S.," says Saks's Bravo.

Despite its global reach and its plans to let in outside
shareholders, Versace was always the archetype of Italian
family entrepreneurship. Gianni was the undisputed cre-
ative genius who sketched from 6:30 a.m. and used his
squad of young designers to follow up his ideas. Santo,
widely acknowledged in the industry as one of the
sharpest business minds around, kept an eye on fi-
nances, from the dozens of complex licensing and fran-
chise arrangements to the ongoing negotiations to take
the company public. Donatella, a designer in her own
right responsible for the \$100 million ready-to-wear
Versus line, runs a virtual in-house ad agency managing



Versace: Many Lines At Many Prices

GIANNI VERSACE Dresses costing up to \$20,000
and high-end ready-to-wear

VERSACE JEANS COUTURE More casual, lower-
priced, but jeans can cost \$200

VERSUS Trendy and affordable ready-to-wear, led
by sister Donatella

VERSACE CLASSIC V2 Men's suits, \$1,500

ISTANTE Ready-to-wear line independent of Ver-
sace name

Versace's major advertising campaigns along with American husband Paul Beck.

It's an organizational setup found throughout Italian industry. "Yes, we are the country of the Borgias, so family

Cover Story

businesses can have a negative side," said Gianni, who cited the infamously sparring

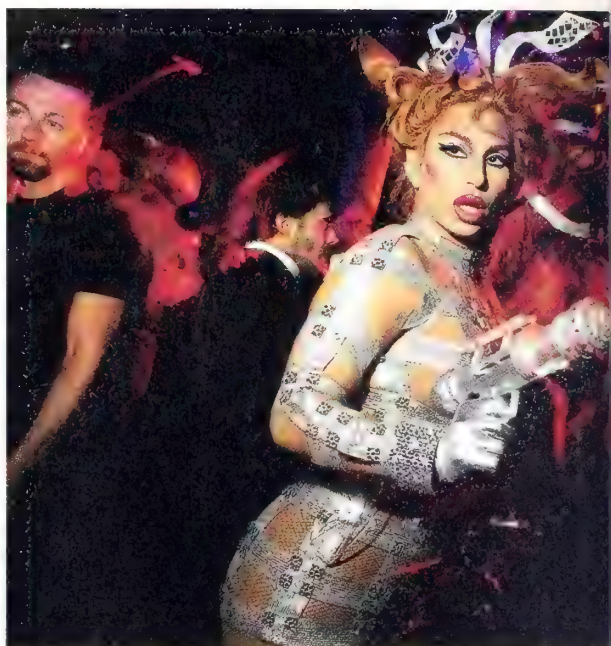
Gucci family as a case in point. "But if the roles are well-defined, it's a big plus." The family link was there from the start. Gianni began designing in his mother's dress store in Reggio Calabria, in the poverty-stricken toe of Italy. He came to Milan in 1972 as a contract stylist for a Lucca-based knitwear group. But in 1976, elder brother Santo left his job as an accountant in Reggio to help Gianni set up on his own, while sister Donatella chipped in to help out on the company's first photo shoots. In 1978, Gianni presented the first women's wear collection under the Gianni Versace label at the first Versace boutique in the tony Via della Spiga. Sales were a modest \$11 million the first year.

But Versace's timing was superb. Milan was just starting to buzz as a fashion center in its own right, and success came quickly. Leaving classic, sober styling to the likes of Armani, Versace hit the fashion headlines with his sexually suggestive, brightly colored outfits. During the 1980s he cemented his love affair with young, rich buyers by cultivating energetically his image as couturier-in-waiting to rock star royalty from Elton John to Rod Stewart, Bruce Springsteen, and Tina Turner. It was a two-way street: Stars like John and Madonna would even step in as Versace models.

HOUSEWARES, TOO. Early on, Versace discovered the power of the brand. Building on his success in women's ready-to-wear, the growing group carefully carved out niches in the market, from menswear lines to the immensely profitable Versace Jeans Couture, a hot-selling lower-cost line designed for younger consumers (chart, page 79). In 1994, Versace rolled out his Home Signature collection of china, upholstery, bed linen, and other houseware items—and he was planning to unveil a cosmetics line next autumn.

This brand extension, or "product pyramiding" as it's known in the rag trade, is the backbone of the leading Italian luxury groups. Gucci is now leveraging its position in leather goods to make a splash in ready-to-wear clothes. "If you have a strong brand," says Salvo Testa, head of the fashion program at Milan's prestigious Bocconi University, "you can take your company just about anywhere."

Keeping a strong image, of course, is essential—and sometimes costly in the short run. Early this year, for example, Versace cancelled a profitable product-licensing agreement with Japan's Mitsui & Co. that brought in royalties of \$6 million a year. Worldwide production, reasoned the Versaces, should be concentrated in just one place to ensure quality. That lesson didn't sink in at famous French fashion houses such as Yves Saint Laurent, Pierre Cardin, and Karl Lagerfeld, who largely lost control over licensing. Before long, markets were flooded with mass-produced brand-name products, fatally damaging their brands' luxury image. "The French used to lead



in brand management," brags Gucci CEO Domenico Del S. who painstakingly restored luster to the leather goods group "but now we're eating their lunch."

Gianni Versace, with its tightly organized head-office team of 250 designers, photographers, public-relations spinners and bean counters follows, the model of most of the big Italian fashion houses. The bulk of revenues—a little over \$1 billion last year at a wholesale level, or \$2 billion at retail—comes from the 15% to 20% royalties received from

'BUSINESS ENTERS INTO EVERY ASPECT OF ART, SEX, AND LOVE'

Amid the priceless art treasures in Gianni Versace's 18th-century palazzo on Milan's Via del Gesù, which was both his home and corporate headquarters, the designer in April gave one of his last in-person interviews, to BUSINESS WEEK's Rome Bureau Chief John Rossant. Dressed in a black cashmere polo shirt, Versace explained that he was trying it out for next year's collection. "When I do menswear," he said, "I experiment with it myself." The following are excerpts from that meeting and from more-recent phone chats:

ON GOING PUBLIC I'm discovering that I'm into business. After so many years of doing fashion, I like the idea of putting my fingers into the business side—of going to the stock market with Gianni Versace. I'd like people to be as crazy for my shares as they are for my clothes. Going public is to say: This is what I've done in the last 30 years... I want [the company] to be perfect when we go to the market.

ON WHO HE DESIGNS FOR Recently I spent two nights in Miami with Madonna. Then, I rushed to New York with Courtney Love. On the way I was in London with Princess Diana. Then back to New York with Cher and Bessette Kennedy. I call them my "er women" because there are for them. They give me inspiration. Their needs are so different. You have to produce something spectacular for Madonna, something classic for Diana, something chic for Caroline Bessette.

ON GLOBALIZATION OF THE FASHION BUSINESS Fashion is more and more global. It doesn't belong anymore to the French. Or even to the Italians. I am a global person: I spend two months in Como [in the Italian Alps], one month in Milan, two months in Miami. I don't think any longer in terms of nationality. Calvin Klein is American, [but he] makes things in Italy. The French makes all have English designers now, women are going global.

WILD THING

This Versace shindig in New York was typical of the fashion world's legendary party animal

manufacturing companies that take Versace designs to produce everything from sunglasses and umbrellas to watches, socks, and suits.

In fact, Versace had taken the process one step further than most designers. It actually has majority stakes in 10 of those manufacturing companies, making it one of the few highly integrated groups in the business. "Versace is unique in its presence across the supply chain, from sourcing to production to retailing," says Yoram Gutgeldt, a textile and fashion-industry specialist at McKinsey & Co.

SMALL NUMBERS. Each company, though, is managed as an independent profit center. Alias, based in Novara about 25 miles from Milan, produces the top-of-the-line Gianni Versace Atelier clothes. Versace

Britain's Princess Di four such outfits in April. Earning around 200 people, Alias racked up sales last year of \$1 million—of which \$21 million returned to the coffers of Gianni Versace in the form of royalties.

Those are still small numbers compared with the competition. New York-based Polo-Ralph Lauren Inc., for example, has three times the wholesale turnover of Versace and is gearing up for renewed expansion following its successful \$1 billion stock offering this June. Paris-based power-

house LVMH, the goliath of the fashion and luxury-brand universe with its \$6 billion in annual sales, recently ponied up \$2.6 billion in cash for a controlling interest in San Francisco's DFS Group Ltd., the world's second-largest operator of duty-free stores. Santo and other Italians are worried stiff that the outlets in places such as Honolulu, Singapore, and Guam will now promote LVMH house brands from Guerlain perfumes to Christian Dior fashions and Louis Vuitton luggage at the expense of everyone else.

High levels of integration can pose risks. Even a fashion group as savvy as Armani has occasionally tripped up trying to be designer, manufacturer, and retailer at the same time. But if the logistics are managed well, integration allows a group like Versace to respond to increasingly short product life-cycles. Owning stores in key cities like New York, London, and Paris has allowed the Versace group to be in direct touch with customers without the filter of a franchisee. "You have to listen to the subtle messages the market is telling you," says Versace's Ballestrazzi.

Versace can also capture more of the rich margins at each step of the game. That's especially important at the retail end, where markups run from around 100% in the U.S. to as much as 300% and more in Japan. And if one or another of Versace's 50 wholly owned stores loses money, as does its flagship Paris store, "we make it up in the manufacturing end," says brother Santo.

He and sister Donatella now can no longer take their time planning the transformation of Versace from designer to brand. Because of their brother's murder, that transformation has been cruelly accelerated. But the sheer strength of Italian design in general and the business drive of the Versace clan suggest that the house Gianni built will continue to thrive—even without its soul.

By John Rossant in Milan, with Gail DeGeorge in Miami



MOGUL

A Milan palazzo served as home and corporate headquarters

ON ITALIAN FASHION I've been on the cutting edge for 20 years. If I didn't have this Italian background of culture and family I

couldn't have done it. Italy's strength is a historical fact: We have the textile industry, we have the tradition of family work, and the tradition of quality.

ON ART COLLECTING The person I admired most was Andy Warhol. He used to say to me: "Even Michelangelo got paid for doing the Sistine Chapel." Business enters into every aspect of art, sex, and love. To those artists who say they're doing it for the love of art, I say: Get real.

ON THE FASHION INDUSTRY Fashion is going through a crisis now, and we see a lot of designers disappearing. We've survived because we're younger and lighter-hearted. Armani's survived, though he's chosen a different path. But for me, the important thing is to roll up my sleeves and work. I can have a great season, and then the next one will be a disaster. You never know.

There is a band of people who
live in your neighborhood.

They roam the streets.

And come into your businesses.

Some people claim they are prophets.

Others say they are maniacs

who have so many formulas

running through their heads

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**GTE CEO LEE
IS NOT
DISCOURAGING
MERGER TALK**

TELECOMMUNICATIONS

TAKE A NUMBER IF YOU WANT TO GRAB GTE

Telecom giants such as AT&T, Sprint, and Cable & Wireless are possible suitors

When merger talks between AT&T and SBC Communications Inc. broke off in late June, about \$3 billion in market value was created. No, not at AT&T or SBC. The big winner was GTE Corp., where the stock jumped 9%, to 47, before settling back recently to 46. Why? Wall Street is betting that AT&T still wants to buy its way into the local telephone market, and acquiring GTE looks like the best way to do it.

AT&T will have to get in line. GTE, once the homely stepsister of the regional Bells, has blossomed into one of

the most desired partners in the big merger dance sweeping the telecom industry. Besides AT&T, Sprint and Cable & Wireless have been mentioned as possible suitors. MCI Communications Corp. talked with GTE about an alliance last year and still is interested. Of all the local telecom companies, "GTE would be the one we would partner with," says Timothy F. Price, MCI president.

GTE Chief Executive Officer Charles R. Lee isn't discouraging such talk, either. That's because even with \$21 billion in revenues last year and 20 million telephone lines, Stamford (Conn.)-based

GTE may not be big enough to go alone. Compared with AT&T, MCI-Bell Telecom, Sprint's alliance with France Télécom and Deutsche Telekom, or even the merged SBC-Pacific Telesis, GTE looks downright puny. That makes it tough for it to go after lucrative business customers, especially those that need an international telecommunications provider. "I'll continue to explore other business arrangements to the extent that they make sense for the benefit of our shareholders," says Lee. "AT&T is our biggest customer. MCI is our second-biggest customer. We talk to

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Information Processing

telecom companies] all the time."

Why is GTE suddenly getting loads of attention? One key reason is that Lee is spending heavily to improve GTE's traditionally weak position in the exploding Internet and data markets. In May, the company agreed to pay \$616 million for BBN, which provides Net access for big corporations, such as Hewlett-Packard and Intel, and it has plans to pour \$2.5 billion into beefing up its data gear over the next five years. Part of the cash will buy GTE capacity on Qwest Communications Corp.'s 13,000-mile national fiber network. The goal: to offer business and residential customers Net access and high-speed data lines, along with traditional voice service. What's more, the company cut a deal with networking giant Cisco Systems Inc. to jointly design and manage private corporate data networks.

STRONG SUIT. But GTE isn't just riding the Internet wave. Its historical weakness also is becoming a strength—namely, its scattered operations. In 1913, AT&T was forced to stop gobbling up the country's independent phone companies as part of an antitrust settlement. GTE was born out of the leftovers, creating a company in largely

rural and suburban markets, hopscotching across 28 states. What had been a costly, inefficient system, though, now offers a key advantage: a national footprint. An acquirer could use GTE's markets as bases from which to launch assaults throughout the country. Today, some two-thirds of the U.S. is within 100 miles of GTE's turf. "None of the [regional Bell operating companies] has that kind of footprint," says Tom Aust, senior telecommunications analyst for Citicorp Securities Inc.

Another advantage GTE has over the Bells: It's getting into long distance now—while the Bells need to wait for the regulatory approval required under the Telecommunications Reform Act passed last year. Since starting to offer long distance 17 months ago, GTE has signed up 1.3 million customers. Meanwhile, GTE's local markets are more protected than most. "Since they're in second-tier markets,

competition is going to get there a little more slowly," says Richard Brown, CEO of Cable & Wireless, who declined to comment on whether his company is interested in GTE.

Lee, who came to GTE in 1988 as chief financial officer from Columbia Pictures and rose to CEO in 1992, has

WHAT MAKES GTE ATTRACTIVE

*An acquirer could
use GTE's markets
as a base*

LOCAL One of the biggest local companies in the country, GTE has 10 million lines from Hawaii to Florida, positioned around major metropolitan areas, including Dallas and Los Angeles.

LONG DISTANCE Since initiating long distance last year, GTE has signed up 1.3 million customers, mostly from AT&T. So far, regional Bells have been banned from offering long-distance service.

GTE already done a good job of sprucing up its profits. Earnings before extraordinary charges rose 10% last year, to \$2.3 billion. Since '92, profits have surged 80%. But sales since '92 rose a slim 9% to \$21 billion. Now, Lee, 57, wants to double revenues to \$38 billion by 2001. "We're basically changing this company from being a good, strong performer... to becoming a growth company," he says.

BEST-IN-CLASS PASSENGER ROOM



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at growth will come at a cost. ding on data services and local eting will likely depress earnings e next two years. Net income is ted to drop to \$2.77 billion this from \$2.98 billion in 1996, says k J. Governali of Credit Suisse Boston. Still, most think Lee is e right course. "The impact on gs will be dilutive, but the strat- will enhance long-term competi-

is paying \$616 million for neer BBN and plans to spend \$2.5 billion on data gear. It deal with Cisco Systems to porate data networks.

SERVICES GTE has taken of its range of products by in unregulated division to sell ecom services.

DATA COMPANY REPORTS

ess," says analyst Jeff Silverman rst Union Corp., which holds 5.4 n GTE shares. r Lee's plan to work, though, he squeeze growth out of GTE's local ations, which account for almost hirds of revenues. Last month, GTE a regulatory loophole to split its lo- service into regulated and unregu- divisions. The regulated company

will offer plain-vanilla phone service at regulated prices. The unregulated company will develop new services and pricing strategies to sell bundled services outside GTE's franchise area.

One example of what the unregulated unit can do: In June, GTE teamed up with Microsoft Corp. to sell unified messaging for voice, fax, and E-mail in Tampa and Dallas. If all goes well, the service will be rolled out throughout the country early next year. "The strategy is to cannibalize your own network and poach on the RBOCs in hopes of capturing a larger return," says Citicorp's Aust. "That is a risky, but sophisticated, response to the [Federal Communications Commission] screwing up local phone deregulation."

IT'S WORKING. The unregulated division's main focus will be small and mid-size businesses within 100 miles of its territory. "We have to be fast and perform under market-driven models that are not based on traditional monopoly rules and time lines," says Lew Wilks, president of the new competitive local company, GTE Communications Corp. That allows GTE to capitalize on having a familiar brand, spend less on marketing, and save on network installation.

It's starting to work. Debbie Johnston, financial director of Feldman Orthodontics in Tampa, decided to switch

long-distance service from AT&T to GTE last year. Her 24-person office racks up about \$3,025 in phone bills each month for high-speed ISDN lines, cellular phones, local, and long-distance service. "I figure we save about \$200 or \$300 a month by doing it altogether with GTE," she says.

But going after Big Business will be a lot tougher. With its rural base, GTE doesn't have a presence in most major metropolitan areas or much experience with Corporate America. A marquee merger partner—such as AT&T or MCI—could make a difference in wooing big corporations. GTE could also use some help in repairing the image problem it has with its bread-and-butter residential customers. It ranked dead last in a J. D. Power & Associates Inc. survey on consumer preferences last year.

Still, Lee thinks GTE's future is bright. With the company's push into the Internet and long distance, he expects sales to increase by 10% to 12% a year starting in 1998, from its historical 6% to 8% range—and perhaps even higher. "We would hope to do better," he says.

He has reason to be confident. Although the telecom industry is getting more cutthroat, Lee probably won't be going it alone.

By Susan Jackson in Stamford, Conn., with Catherine Yang in Washington

THE ONLY FULL-SIZE SPORT UTILITY THAT CAN SEAT UP TO NINE: **EXPEDITION**



THE NEW FORD EXPEDITION.



THE INTERNET

GET YOUR HANDS OFF MY .COM

Conflict over Web monikers is rising. Who will be the arbiter?

What's in a name? That which we call a rose

By any other name would smell as sweet.

—Shakespeare, *Romeo & Juliet*

Too bad the bard's sentiments in that classic tale of star-crossed lovers doesn't apply to Net-crossed companies. Just ask Juno On-

line Services LP. For the past 15 months, the New York-based company has been offering its millions of members a free, ad-based Internet E-mail service. But late last year, Juno received notice from Network Solutions Inc. (NSI), the Herndon (Va.) company that administers and maintains Net addresses, that its domain name—juno.com—was in dispute.



WEAPON OF CHOICE. Lampmaker Juno Lighting Inc., in Des Plaines, Ill., claims to have held a trademark to the "Juno" name since the late 1970s and insists that juno.com is an infringement of its trademark. If the courts uphold Juno Lighting's claim, Juno Online could be forced to turn out its lights and upset service for its 2.5 million members.

And that could be just the beginning. Disputes over Internet domain names—the electronic addresses that Web sites use—are becoming more frequent as

the Net explodes and becomes a corporate hangout. Now, players scrambling to get choice Net names are finding themselves fighting off other companies (table). And increasingly the weapon of choice is trademark law. Take Candyland. Last year, toymaker Hasbro Inc. successfully fought off Internet Entertainment Group Inc. (IEG) for www.candyland.com. Hasbro, which has held a 47-year trademark on the children's board game, won back the domain name after the courts ruled that IEG's site—an online porn page—was a clear case of trademark dilution.

What's the solution for warding off such disputes? Most detractors

MYCOMPANY.COM

What's in a Name?

WWW.CANDYLAND.COM Hasbro successfully fought Internet Entertainment Group, operator of an online porn service, for the return of the Net name—which has been the trademark for a kids' board game for over 47 years.

WWW.JUNO.COM Juno Lighting claims that Juno Online is infringing on its trademark for lighting products. Legal spectators doubt Net surfers will confuse the free E-mail service with lights.

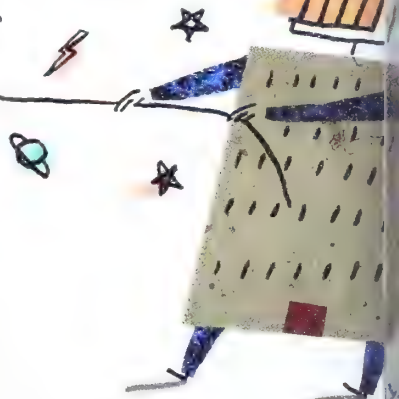
WWW.PRINCE.COM Prince Sports Group fought with consulting company Prince over this domain name. The consultant has a trademark for "Prince" and has been using it for two years in Britain.

say the domain name registration process must change. Previously, NSI registered names on a first-come, first-served basis. But last year, NSI changed its policy to allow any trademark holder to contest registered domain names. If the plaintiff proves that it has legal right to the name, NSI will "turn off" the domain name in question. The only recourse for current domain name hold-

ers is to countersue to keep the name available until the dispute is settled.

As a consequence, many now advocate changing the process and eliminating NSI's lock on the ".com" suffix—the address that identifies "commercial" entities on the Net. The Internet Address Committee (IAHC), a group of Net companies and individuals, made such a proposal earlier this year. Their plan: create new suffixes such as ".firm" for companies and ".nom" for individuals and designate international registries to handle new domain names.

JUSTICE LOGS ON. Meanwhile, NSI faces its own legal headaches. On June 28, PGMedia Inc., an Internet concern that is developing an alternative domain name registry, filed suit against NSI. PGMedia claims that NSI's lock on the registration process is preventing it from doing business. At the same time, the Justice Dept. has confirmed that it, too, is interested in the domain name business. It has served NSI



with a civil investigative demand for papers to determine "the possibility of anticompetitive practices in the Internet address registration industry."

The timing couldn't be worse for NSI. The company filed on July 3 with the Securities & Exchange Commission to become a publicly traded company. Officials at NSI wouldn't comment on the legal actions, saying the company has entered the "quiet period" as required by the SEC. Still, NSI spokesman Christopher Clough says that since 1995, when the company received domain name responsibility from the National Science Foundation, NSI has successfully registered over 1.2 million domain names. Of those, only 26 have been disputed, and 22 settled out of court, says Clough.

Still, with the explosive commercial growth of the Net, the name game is far from settled.

By Paul M. Eng in New York, Marsha Johnston in Paris

HEY'RE GOING SPACE CRAZY

Business has some wild ideas in orbit. But who knows?

On the spectacular rock-strewn surface of the Red Planet, the Mars rover creeps along at a snail's pace. On earth, however, the star mania's latest trip to the planets is going off store shelves, that is—as people snap up thousands of Mattel-made models of the Sojourner for \$5 each. As yet, there's money to be made exploring the final frontier. But it's not the predictable toys and B-movies. The Mars Pathfinder mission reawakened Americans' romance with space exploration, companies are boldly dreaming of where none has gone before. Mine-park rides on the moon? Mines on asteroids? Trips into orbit, colonies on Mars? They're all in the business of a handful of companies and entrepreneurs with stardust in their eyes. Many of these dreams may never come true. But don't underestimate the power of free enterprise to jump-start humanity's push to the

planets, says Robert Zubrin, founder of startup Pioneer Astronautics in Lakewood, Colo., and author of *The Case for Mars* (The Free Press). "We're at the dawn of a new era in space," he proclaims.

Of course, space is already a huge business. Satellites for TV, telecommunications, global positioning, weather, and other functions, along with rockets to launch them and earthbound controllers and processors, added up to a \$77 billion industry last year, according to a new report from KPMG Peat

Marwick LLP and three collaborators. For the first time, commercial revenues actually surpassed government expenditures. NASA, meanwhile, is taking steps to privatize operations. Last year it handed prime responsibility for the Space Shuttle to a joint venture between Boeing Co. and Lockheed Martin Corp. And with constellations of new satellites planned for personal phone services and remote imaging, analysts estimate growth of commercial space businesses at 20% per year. "After a lot of hype in the mid-1980s about commercial space, we're finally at a point where people are plowing their own money into it," says Peter M. Stahl, an analyst in Marwick's commercial space and high-technology group.

A few brave souls are looking beyond mundane orbiting satellites. Casting about for a way to make money in space, former software

ROCKY ROAD:
Pathfinder's view of Mars



MARS 2020?

What it might look like

magnate Jim Benson created SpaceDev LLC to explore asteroids. He points out that there are more than 400 known bodies zipping near earth, some laden with resources such as steel, gold, platinum, and water. Benson doubts it's worth hauling this booty back to Earth. But when it costs thousands to supply a few glasses of water to the space station, water and building materials on nearby asteroids become attractive.

MINING ASTEROIDS. In addition to prospecting and perhaps mining asteroids, Benson figures that SpaceDev can build and operate space probes more cheaply than NASA and thus win contracts from governments and research bodies anxious to do more science in space. For less than \$50 million, SpaceDev plans to shoot a spacecraft to an asteroid, land an instrument to prospect the body's wealth, and lay claim to its resources. The target hasn't yet been picked, but the mission could come as early as 1999. "We're trying to get the franchise on private space exploration," Benson says.

NASA is surprisingly comfortable with schemes such as Benson's. This fall, the agency's own Lunar Prospector mission will send a probe to orbit the moon and scope out resources, including water. The entire mission, including a spacecraft built by Lockheed Martin, is budgeted at just \$63 million.

Making unearthly profits, however, is no easy task. Just ask LunaCorp, which has been trying to mount a private mis-

For years, the phrase "800 number" has been synonymous with high-quality customer service and easy consumer access. In the near future, another number is likely to join these prestigious ranks: 1-900.

Once little known among business and consumers, the 900 number industry is in the midst of a vigorous expansion, growing by more than 10 percent a year over the last five years. The industry's most rapidly expanding segment: everyday business-to-business and business-to-

consumer applications.

"The 900 number is finally reaching its potential as a business tool," notes

Edward J. Keyes of the International Center for Communications at San Diego State University.

"And why not? It's more convenient than mail-in payments, and less expensive than credit cards."

In fact, because the 900 number's "pay-per-call" charges are added to users' existing telephone bills, billing and collection difficulties are negligible and convenience is maximized for businesses and callers alike.

Packard Bell NEC, which chose AT&T's 900 Services as its pay-per-call solution, has found its 900 number (900-555-3388) to be a cost-effective way to provide customers with high-quality training and software support, beyond Packard Bell's traditional toll free number.

"Our customers know what they want, and our goal is to make sure they get it as efficiently as possible," explains John Sientz, manager of Packard Bell's Premier Support program. In most cases, "they've already tried reading the manual. They're looking for someone to offer immediate help, and that's what Premier Support is all about."

In effect, the Packard Bell program extends the warranty protections that come with all of the company's computers so that customers with out-of-warranty systems can continue to receive technical support for hardware, peripherals, and software for a nominal fee of \$2 per minute and a maximum of \$35 per incident.

While Packard Bell also offers a credit card support option, most customers choose the 900 number. In fact, satisfaction with the program is so high that in one informal survey, the company found that more than 97 percent of customers would choose the 900 service again. Mr. Sientz credits Packard Bell's staff for this success.

"Our people love solving a tough problem," he says "and they have the resources to do it well."

Other companies are using AT&T's 900 Service to improve customer service in similar ways. For example, in addition to its 800 number and an Internet help site, Nintendo offers a 900 number (900-288-0707), for \$1.50 minute, for gamers needing assistance with the company's video games. In a somewhat different vein, the Turner Broadcasting System (TBS) employs a 900 number for high-profile call-in promotional events.

But one of the most innovative applications of 900 numbers comes in an industry long plagued by high overhead costs and intense marketing challenges—charitable fundraising.

Ronald McDonald House Charities (RMHC), the Illinois-based family support services arm of the nationwide fast-food retailer, recently signed on with AT&T's 900 Services in order to find another way to make things "fast and convenient."

"We're always looking for new ways to raise money," says Marty Coyne, Director of Development for RMHC. "And we recently turned to our long-time partner AT&T to see if they could help." Help they did. Each 900 call (to 900-CALL RMHC) results in a \$15.00 contribution to the RMHC.

A donor does not need to write a check, find a stamp, or receive monthly reminder statements—it's simply a charge on the local phone bill.

As examples like these illustrate, the promise of 900 service is great, and likely to become even greater as new applications are added. Businesses soon may find that 900 numbers are an ideal—an increasingly necessary—companion to the 800 numbers they have long used to provide their customers with the best in service and support.

"The 900 number is finally reaching its potential as a business tool..."

—Edward J. Keyes,
International Center for Communications,
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AT&T

sion to the moon for four years. The Arlington (Va.) company wants to send up a robot vehicle bristling with cameras and corporate logos. TV networks, in theory, would then buy exclusive footage, and visitors to amusement parks or space museums could experience the thrill of driving the rover across the lunar surface. Trouble is, LunaCorp can't find buyers for the \$150 million mission. "There's an imagination barrier," laments LunaCorp exec Victoria Beckner. "Companies still think of space exploration as being the government domain." Similarly, Pioneer's Robert Zubrin dreams of commercial colonies on Mars. But he admits that "it's hard to sell a business plan that says, 'We'll go to Mars, Mr. Gates, on your money.'"

CHEAPER ROCKETS. The towering hurdle for all of these space ventures is cost. The price tag for a launch is still typically \$50 million or more for a big communications satellite, or \$8,000 to \$25,000 per pound. That's why the busiest outpost on the commercial space frontier is the rocket business (table). A large cost reduction, explains Michael S. Kelly, president of Kelly Space & Technology Inc. in San Bernardino, Calif., "will all of a sudden make a whole bunch of potential space businesses financially viable."

The conservative strategy is to find ways to shoot off traditional, expend-

able rockets more cheaply. Boeing, for instance, has a large stake in Sea Launch Co., which is converting an oil rig to a floating launchpad that can be hauled by boat to the optimal ocean launch spot. Boeing is also pumping millions into rocket research. "Things will take off as we get smarter," says space transportation program manager Dana G. Andrews.

The startups say they have one big advantage over aerospace giants: no cumbersome bureaucracy. Rick Fleeter, president of tiny satellite and rocket maker AeroAstro LLC in Herndon, Va., is building a demonstration rocket for the Air Force powered by an engine he made for a mere \$100,000—compared with the \$2 million to \$4 million it would cost to buy one.

Other companies believe the key is reusable rockets. Kelly wants to enlist a Boeing 747 to tow his delta-winged spacecraft, the Eclipse E-100, into the air. Kistler Aerospace Corp. in Kirkland, Wash., is using old Soviet rocket engines to create a two-stage reusable vehicle. And Pioneer Rocketplane, co-founded by Zubrin in Colorado, is building a piloted spacecraft that takes off like a jet plane. Such a ship could also function as a hypersonic delivery truck,

MARS: Image captured by Viking probes

argues Pioneer executive vice-president Mitchell Burnside Clapp. "I'd like to make the claim that we can deliver a package to San Francisco the day before it was sent from Japan," he says.

None of these Buck Rogers schemes is guaranteed to open up the space frontier. Indeed, some competitors may be reeling too high. "If everyone was

so busy trying to cut launch costs by a factor of 10 or 100, we could easily cut them by two or four," frets AeroAstro's Fleeter. What's more, the claim that the private sector must take over space exploration could be counterproductive, prodding Congress to cut funding for future missions. That worries Larry Friedman, executive director of the Planetary Society, who likens space exploration today to the great era of government-funded voyages of discovery in the 1400s and 1500s. It was only explorers such as Vasco da Gama and Columbus finished their voyages in the Dutch East India and Hudson companies rushed in. In the same way, today's Pathfinder may be a small step toward business in space.

By John Carey in Washington, and Neil Gross in New York and Scott Browder in Seattle

Dreaming of Space

As NASA downsizes and privatizes its operations, a 21st century commercial space industry is struggling to be born. Here are some of the dreamers that companies—large and small—are trying to make real:



AEROASTRO
Herndon, Va.

Building cheaper rockets and satellites for telecom and science missions

BOEING
Seattle

Majority owner of Sea Launch, a venture to launch rockets from a movable ocean platform

KELLY SPACE
San Bernardino, Ca.

Its reusable rocket would be towed off the ground by a Boeing 747

KISTLER AEROSPACE
Kirkland, Wash.

Its two-stage rocket achieves soft landing on Earth, thanks to parachutes and air bags

LOCKHEED MARTIN
Bethesda, Md.

Its X-33 rocket will take off vertically and glide to landing. Projected costs: Below \$1,000 a pound

LUNACORP
Arlington, Va.

Wants to put a rover on the moon that theme-park visitors would "drive" from afar

PIONEER ROCKETPLANE
Lakewood, Colo.

Designing craft (at left) that takes off like a plane and gets rocket propellant from a tanker

SPACEDEV
Steamboat Springs, Colo.

Planning privately funded mission to asteroid to study mining potential

SUCCESSFUL SALES PRESENTATIONS

The Technology and Techniques



by Claudyne Wilder

MAKING AN EFFECTIVE SALES PRESENTATION WITH MODERN TECHNOLOGY CAN BE EXCITING, CREATIVE — AND ULTIMATELY PUT YOU AHEAD OF THE COMPETITION. ALL IT TAKES IS PLANNING.

In this special section are a few valuable suggestions on how to evaluate technology choices, how to identify software options, and how to put them all together.

WHERE TO BEGIN: Equipment Considerations

Audience size and type of presentation will determine the type of equipment the presenter needs. For a presentation to one person, a laptop is usually sufficient. For two or more people, a monitor or a projection system (i.e., LCD Panel or LCD or DLP Projector) is necessary.

If the presenter opts to use the client's monitor, a call should be made in advance to be sure the correct type of equipment is

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available — and that the laptop is compatible. If the presentation calls for a projection system, the question becomes whether to purchase and carry one, or be at the mercy of the customer's system. It's better not to rely on the client's equipment because it's often outdated or malfunctioning. It makes no sense to show a fantastic color presentation with video clips using an old overhead projector and LCD panel created to project multiple black and white images.

LCD Projectors

Increasingly, presenters are using LCD projectors as recent advancements have overcome their two biggest drawbacks: weight and light output. LCD panel manufacturers now make LCD projectors with a built-in light source that puts out 300–600 lumens — a good order of magnitude and more than could be had previously from an LCD panel and overhead projector combination.

In some cases LCD projectors weigh under ten pounds. Other advantages are: there is no overhead arm blocking the audience's view; LCD's are quieter with only one cooling fan instead of the two that are needed for an LCD panel; and they take up less space.

Some high-end machines provide true multimedia capabilities including multiple computer and video inputs. LCD projector prices start at about \$3,000 and go as high as \$10,000.

Following are some considerations companies need to discuss with dealers before investing in an LCD projector.

Start with an analysis of your company's sales presentation needs by asking the following questions:

Who will be using the equipment?
What is their level of technical expertise?

How will the equipment be used?
Systems are made with a wide range of connection choices — from two video sources to two computer inputs. Decide how many source connections are needed. For example, will you connect to just one laptop or two? Will you be showing video?

Will the equipment be carried? Who will carry it? Today's LCD projectors

weigh as little as nine pounds and can go up to almost 40 pounds. Portables weigh from 13 to 19 pounds. Ultra-portables weigh from nine to 12 pounds. However, the lighter projectors don't provide all the features available with heavier units.

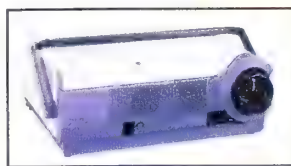
The presenter who travels from city to city giving sales presentations to small audiences (20 to 30 people) doesn't need to carry a heavy projector with unnecessary features. But if the audience is large or multimedia is used, a heavier machine will be necessary.

What type of computers will be used? Will all the computers be the same brand and have the same features? All LCD products are both PC/windows/DOS/MAC compatible. Most support world-wide video standards, including NTSC, PAL and SECAM and have universal power supplies for foreign travel.

What is the resolution of your existing equipment? Resolution represents the number of horizontal and vertical scan lines that make up computer screens. As computers achieve higher and higher levels of resolution, you may want to consider a system that offers intelligent compression. This means it can handle whatever is plugged into the projector. However, adding all the available bells and whistles usually produces a poorer image.

Will you be projecting bright, colored screens? In addition to smaller size and weight reductions, the other major breakthrough in LCD technology has been in image brightness.

ANSI (American National Standards Institute) Lumens are the most accepted standard used to measure image brightness. The higher the ANSI Lumen rating, the brighter the picture. As a rule of thumb, a projector that puts 300 or more ANSI Lumens on the screen will provide the bright image you want without having to dim the lights. With the lights up, the presenter and audience can see each other, and the audience stays more alert. In terms of selling and staying connected to



Philips LC3500

COMPUSA UPGRADES TRAINING ROOMS WITH PHILIPS LCD PROJECTORS

Teaching customers to use an extensive range of computer software is a key part of the success of CompUSA, one of the nation's leading retailers and resellers of personal computers. Over 400 training rooms in more than 100 centers nationwide are used to teach thousands of individuals how to work with software applications.

CompUSA's quest for better quality and service finally led to Philips, where the company found a solution which they believe will serve their projector needs long term.

The proven dependability of Philips projectors, and the company's record of responsiveness, were an important part of the equation to keep CompUSA's training operation running smoothly.

CompUSA has initially upgraded 90 training rooms with Philips LCD projectors as part of an overall store remodeling program. In addition, Philips projectors are scheduled to go into all new CompUSA locations this year, and the company is considering a program to install Philips LCD projectors in the training rooms of all their locations nationwide.

an audience the extra cost for brightness may very well pay off.

However, because Metal Halide lamps require a transformer, they add more weight to the projector. Metal Halide lamps last more than 1,000 hours compared to the halogen lamps which burn out in 40 to 70 hours. However, Metal Halide lamps cost several hundred dollars to replace and, in some cases, must be replaced by a trained technician.

Some projectors with the halogen lamps have a two-lamp socket. If one of the lamps burns out, you can move a switch and use your spare lamp. During your dealer demonstration, ask to change the lamp; doing so may prevent an embarrassing situation in front of 20 or more potential customers.

SOFTWARE CHOICES

Freelance Graphics from Lotus enables more than one person to view a presentation simultaneously by simply

LITEPRO 720 FOCUSES ATTENTION ON SOFTWARE FOR INTUIT

The root of all evil may be money, but the road to financial salvation lies with Richard Katz, Intuit's evangelical-like User Group Consultant. The gospel according to Katz is Intuit's Quicken, the world's most popular financial software program. To deliver his message he uses the LitePro 720 multimedia projector by In Focus.



InFocus LitePro 720

When Katz delivers his "sermon" to the growing faithful, he simply hooks up his laptop to a LitePro 720 and projects powerful digital images onto a big screen. The LitePro gives him a palette of 16.7 million colors, and combines video, sound, graphics, and text into splendid multimedia displays. And thanks to the LitePro's remote control, Katz isn't grounded to the projector. This is important, because he runs up and down the aisle shouting, handing out chocolate gold coins proclaiming that "Quicken makes the horrors of paying bills a snap." In spite of all the hyperactive enthusiasm, Katz says he finds his LitePro 720 friendly and easy to use.

The same adrenaline infuses his description of the LitePro's luminosity: "It's like a supernova," says Katz. "I recently gave a presentation at a GE facility in Kentucky where it was necessary to project a 30-foot image. The presentation was still bright enough to be clearly seen from everywhere in the hall — even with the lights on. It was amazing!"

saving the presentation to the internet (it automatically saves to HTML [Web] format). When e-mailed to someone who doesn't have Freelance, the presentation can still be viewed through the use of Browser Ad-Ons. *Web site: www.Lotus.com*

PowerPoint 97 converts presentations for playback on the Web or a corporate intranet. There are more than 50 presentation templates and an animation feature that, previously, could only be found in programs like Astound. You can also record your script directly onto a disk and send it to a customer or put it on your Web site. PowerPoint's Office 97 Suite comes with over 4 million images, animations, and audio — as well as a

Pack and Go feature that takes you through the process of copying your files to a disk. *Web site: www.Microsoft.com*

Astound lets PowerPoint users open and edit existing PowerPoint presentations. Elements spin, grow, and bounce into place. Bullets, charts, and slides come to life with audio, video, and interactivity. Any shape, picture, text block, or multimedia object can trigger jumps to other areas of a presentation, other applications, or even to the Web. The animation effects can be synchronized with Astound's powerful timeline feature. The user can take a presentation from slide to screen to Web with no knowledge of HTML or other programming languages. *Web site: www.astound.com*

Corel Presentations 8 offers a customizable Background and Layout Gallery to mix and match layouts. It includes 91 Master (Design) templates, 20 slide transitions and numerous object and bullet animations. There are also 12,000 clip art images, 1,000 True Type fonts, and 250 photos. It also supports Intel MMX Technology, and original slide shows can be tailored for multiple audiences without having to save multiple versions. Corel Presentations 8 also incorporates extensive Internet connectivity which facilitates publishing of slides, slide shows or graphics directly to the Web — complete with full animation, transitions, and sound video. *Web site: www.corel.com/products/wordperfect/cp8*

Macromedia Director has the Director 6 Multimedia Studio with streaming Shockwave which creates interactive multimedia content on CD-ROM, DVD-ROM, or the Web. The Studio creates and integrates graphics, audio, video, animation, and interactivity to deliver sales and marketing demos, product tutorials, CD-ROM games, Kidsware, and interactive advertising. *Web site: www.macromedia.com*

Active Presenter includes everything users need to create, publish, and deliver moderated presentations over the Web without needing any background presentation graphics or HTML. Other features include the super compact file size of the presentations (1K per slide on average), and the ability of attendees to join live presentations easily and at any time. In addition, the moderator needs to do nothing more than navigate through a simple wizard to publish the presentations to the Web, maintaining control over the pace. *Web site: www.spc.com*

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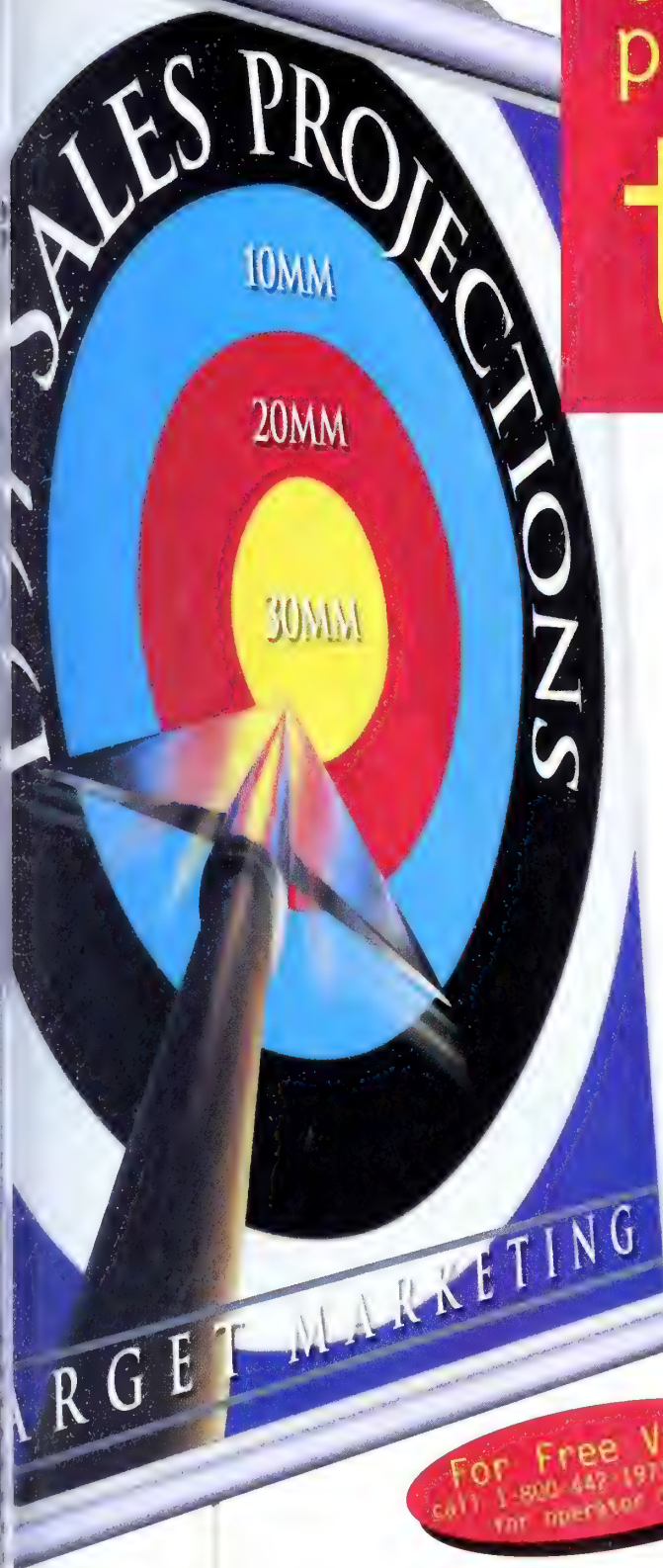
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PRESENTATION DESIGN The Format For The Talk

While it's true that some software packages have ultra-fancy features that add pizzazz to a presentation, there are other, more basic, issues to consider. The first is a format for establishing the presentation's structure. To create the format the presenter must decide what information is needed to effectively motivate the customer to buy.

Rule number one: sell benefits, not product features. The presenter should

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**FRATERNAL SOCIETY
UPGRADES WITH
PANASONIC LCD
PROJECTORS**

Aid Association for Lutherans (AAL) offers a variety of insurance and retirement products to Lutherans and their family members. It has 1.7 million members nationwide.

Bill Stinski, AAL's Administrator of Communications Training and Support, described his company's presentation requirements as sophisticated and intense. "Our home office and nearby satellite offices have close to 100 meeting rooms, and executives also make frequent presentations at our 52 regional offices. We have other projectors, but felt it was time to upgrade to higher resolution (i.e., SVGA) and the brightest available projection. To achieve this level of performance, we recently invested in Panasonic PT-L592U SVGA LCD projectors. They deliver 600 ANSI lumen brightness with 800 x 600 SVGA resolution...and weigh only 20.9 pounds."

Stinski added that he was most impressed with the 3000-hour life expectancy of the projector's metal halide lamp, which provides up to three years of normal use. "We really like the PT-L592U's 'auto mode,' which adjusts to anything we feed to it. That's very important considering the sheer volume of operators who don't want to fiddle with controls. Another feature we're using frequently is the keystone correction, whereby you can simply raise or lower the projector with a thumb wheel - a big help when your presentation rooms vary in size and setup as much as ours do."

Without discussing company history, market share, and how its product was created, the presentation should not be top heavy with technical data. What the customer needs to know in order to make an informed purchase decision is the most important information.

For example, the presenter should highlight specific advantages the company's product has over its competitors - presented in a simple chart or table that makes it easy for the customer to make comparisons.

And whenever possible, testimonials from satisfied customers explaining why they purchased the product and the benefits they received should be provided.

These are only some of the basics that every successful presentation must have. If overlooked, all the colorful screens in the world won't make up for boring the audience. ■



Panasonic PT-L592U

Claudyne Wilder's Boston-based company specializes in presentation training and materials and visual design consultations. Her latest book is *Point, Click, and Wow! A Quick Guide to Brilliant Laptop Presentations*. She can be reached at 617-524-7172 or via E-mail at claudyne@wn.net. Her Web-site address is www.wilderpresentations.com.

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Panasonic
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EDITED BY CATHERINE ARNST

EXPANDING ON MOTHER NATURE'S PHARMACY

A SURPRISING NUMBER OF blockbuster drugs have sprung from one diverse group of naturally occurring molecules called polyketides, which are produced by soil bacteria and fungi. The list includes the antibiotic erythromycin, a cholesterol-lowering agent called Mevacor, and FK506, a powerful immunosuppressant used on transplant patients.

Scientists would like to custom design more of these molecules, but in most cases, the molecules have proven too complex to synthesize. Now, a team of biochemists and organic chemists at Stanford, Brown, and the University of Wisconsin claims to have solved the problem, using a combination of gene splicing and chemistry. The first results, reported in the latest issue of *Science*, are several new variants of erythromycin.

According to Stanford team leader Chaitan Khosla, the researchers interrupted the sequence whereby genes in streptomyces bacteria produce the antibiotic. They then added man-made chemicals to the mutated cells. These are incorporated into the new versions of erythromycin. Khosla and his colleagues have started Kosan Biosciences Inc. in Burlingame, Calif., where they hope to design thousands of polyketides targeted at heart disease, cancer, and drug resistant bugs. *Neil Gross*

AN END RUN AROUND CHEMO'S SIDE EFFECTS?

VETERINARIANS AT COLORADO State University have discovered that a method used to treat bone cancer in dogs shows promise in humans. The key is biodegradable spongy materials called biopolymers that are loaded with cancer-killing drugs and surgically inserted next to a tumor. There they release a constant dose of the chemical directly to the cancer cells, a delivery method less toxic and less expensive than chemotherapy delivered by injections.

Colorado State veterinarians started using the polymers to treat dogs 10 years

ago. The researchers figured the same treatment should work with humans, says William Dernell, assistant professor of surgical oncology at the veterinary center. A recently completed study of 42 mice with breast cancer found that the implanted polymers eliminated all regrowth of the cancer. But breast cancer recurred in half the mice that received chemotherapy by injection. "This opens a wide range of possibilities in developing new drugs to fight cancer and heal the body from the inside," says Dernell.

The research team is now undertaking a study of 180 mice with breast cancer, but Dernell predicts it will be at least four years before the polymers can be tested on humans. □



FIELD OF BEANS: New

INNOVATIONS

■ The U.S. Agriculture Dept. has been hard at building a better bean. Dubbed the Mason variety, this new variety, which will be widely available by 2005, is meant to produce beans that are up to 18% higher than those of other varieties of the bean grown in the Pacific Northwest, home to 95% of the U.S. lentil crop. USDA geneticist Fred J. Muelbauer says the variety is harder and has larger seeds—and they grow higher on the plant, resulting in fewer lentils lost to harvesting. Also, he says, it has eye appeal: The coat is a lovely light red without the ugly black spots found on old-fashioned lentils.

■ Researchers have developed a high-precision laser that can perform surgery on the transparent and flexible cornea of the eye with fewer risks and greater precision than mechanical devices. In virtue of the laser, developed by the University of Michigan in Ann Arbor, is the powerful, ultrashort laser pulses require less energy to cut tissue and so do not create "shock waves" that damage the eye. All tests are under way, and there are plans for testing on humans in the near future, researchers say.

A VOICEBOX TO CHILL YOUR ICEBOX

NOT ALL THE COOL VIBES COME FROM RECORDING STUDIOS these days. A research team at Purdue University in West Lafayette, Ind., is testing a prototype cooling device that uses sound waves rather than Freon. The concept is called thermoacoustic refrigeration.

The cooling device consists of a metal tube with a loudspeaker on one end that produces sound waves. Each wave creates pressure fluctuations that result in temperature changes:



the higher the pressure, the higher the temperature. In the middle of the tube, layers of ceramics draw the heat out of the sound waves before they hit the opposite end. The remaining "cold sound" cools the tube, which in turn could cool water or

some other fluid that could then circulate through a refrigerator or air conditioning system.

Thermoacoustic cooling has been around for more than 10 years, but earlier systems used much more energy than conventional fridges. Luc G. Mongeau, assistant professor of mechanical engineering at Purdue, says his team's prototype was built to be as efficient as possible. If the test pans out, the design will compete with conventional systems, he says. *Elizabeth Veomett*

THE SCRIPT DOCTOR IN AT BLOCKBUSTER—AGAIN

yet another chief executive stop the meltdown at Viacom's video chain?

Corporate disasters go, this one's a beaut. Viacom Inc. paid \$8.4 billion for Blockbuster Entertainment Corp. just three years ago. The rental chain was the cash cow that had Viacom to acquire Paramount Communications Inc. that same year. It went well for a time, but in recent years, Blockbuster's deterioration has shocked Wall Street, the entertainment press, and, apparently, the top brass

at Viacom. "Is it worth \$2 billion? \$4 billion? I don't know," says Furman, Selz LLC media analyst David B. Doft. "According to many on the Street, Blockbuster is worth zero." Viacom's stock now trades at half its 1993 value.

In little more than a year, Blockbuster has had three chief executives—Steven R. Berrard, Bill Fields, and now, John F. Antioco—and at least as many public declarations

of a new strategic direction. In July, in what has become almost a quarterly exercise, Viacom announced that Blockbuster's second-quarter results will fall below analysts' expectations, with cash flow down a stunning 70%, to as little as \$40 million. It also will take a \$300 million charge chiefly for bad inventory—movies it mistakenly thought people wanted to see and merchandise, such as candy, it thought they would want to

VIDEO KINGS, RECENT STORY

Blockbuster has had three CEOs and at least as many strategies since March, 1996. Here's how the company fared over the reign of each.

BY JEFFREY M. HARRIS
AND JEFFREY M. HARRIS



STEVEN R. BERRARD

Mentor, Wayne Huizenga, sold Blockbuster to Viacom for \$8.4 billion. Berrard stayed to run the company, which expanded aggressively, especially overseas. Margins were high, thanks in part to a big write-down. Quit in March, 1996. Blockbuster Video cash flow in 1995: \$785 million.

BILL FIELDS

The Wal-Mart veteran vowed to transform stores into entertainment centers. He centralized distribution and moved headquarters to Texas. A third of the executives left. Analysts valued the company at \$4.2 billion. Fields left in April, 1997. Cash flow in 1996: \$773 million.

JOHN F. ANTIOCO

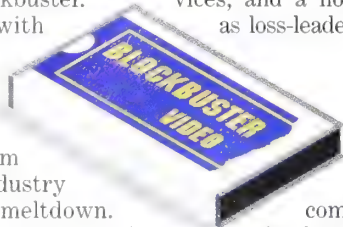
After the former Taco Bell head agreed to take the Blockbuster challenge, Viacom called its strategy to diversify Blockbuster flawed and said it would pull back in foreign markets. Analysts now value the company at only \$2 billion. Estimated 1997 cash flow: \$500 million.

buy. Notes Phillip Foreman of Composite Growth & Income Fund, which owns more than 300,000 Viacom shares: "Clearly, Viacom doesn't have a handle on what's going on at Blockbuster." Viacom and Blockbuster executives declined to comment for this story.

DEADLY COMBINATION. Given their silence, it's difficult to know what exactly is going on inside Blockbuster. But based on interviews with former executives, suppliers, and competitors, an alarming, if incomplete, picture emerges. Blockbuster is suffering from a deadly combination of industry change and an operations meltdown. When the video-rental business was booming, Blockbuster's success was measured by fat margins and revenue growth. Now, the company has to be run well in a much tougher climate. Notes one entertainment industry source: "Blockbuster never had the controls. When there was a slowdown and a shift in the way business is done, it all came home to roost." While Fields and Berrard had free rein, industry sources say Antioco is being closely supervised by Viacom Chairman Sum-

ner M. Redstone and Vice-Chairman Thomas E. Dooley.

The crisis comes as the video-rental business is in flux. The industry has suffered a general softness, and consulting firm Alexander & Associates says rentals will fall 4% this year, amid a dearth of hit releases, the growing popularity of movie-rich satellite services, and a flood of videos offered as loss-leaders by discount stores.



Redstone himself appeals

Despite this, some rival video-rental companies are thriving. Analysts expect Hollywood Entertainment Corp. and Video Update Inc. to post about a 4% sales increase in the second quarter, while Blockbuster's sales may dip about 5%. "Blockbuster is a fairly rudderless ship at this point," says Curt Alexander, a partner at Media Group Research in Providence.

Then there's the revolving door—and not just in the executive suite. Blockbuster has lost so many key people that a good deal of the institutional memory about how the company runs appears

to have been lost. A third of its senior executives and two-thirds of its overall staff left earlier this year, when Fields moved headquarters from Fort Lauderdale to Dallas. With so many people gone, the company is actually repeating mistakes it made years ago, stumbling in basic store operations, former executives say.

Blockbuster's plan to handle its distribution has also backfired.

That 818,000-square-foot distribution center that broke ground in January near Miami has been plagued by everything from bad planning and floods to construction delays. To save money, the company left its old distributor before it was ready to switch to its own automated system.

That, says analyst Tom Wolzien, Sanford C. Bernstein & Co., means Blockbuster is reduced to using manual laborers to hand-pack boxes bound for Blockbuster's 5,688 stores. That has created even more problems, as "some of the tapes are just walking out the door" without the workers, Wolzien says. "It's a case of stuff falling off the truck."

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distribution fiasco runs a lot deeper than some purloined tapes: Anecdotal evidence suggests new releases aren't making it to neighborhood Blockbuster stores either "street date"—the date when another video store in town has it. If that makes matters worse, it now looks like consolidating distribution won't make Blockbuster much money anyway. Former CEO Fields thought that centralizing buying power would enable Blockbuster to pressure suppliers—Hollywood studios—to lower prices. That strategy worked well for Fields when

studios. He asked them to voluntarily cut the prices of the tapes they sell to Blockbuster by as much as 15%. Redstone's request was ignored. "We just kind of stared him down on that one," says one top studio executive.

Under Fields, Blockbuster tried to goose sales by diversifying from video rentals into videos sales and T-shirts, toys, books, magazines, and CDs. The move proved disastrous. For one thing, those products had lower margins than video rentals. Bizarrely, Blockbuster had already learned that diversifying mer-

most of his career at convenience stores. As Blockbuster's latest chief, Antioco made his first quasi-public appearance in mid-July at the industry's largest trade show in Las Vegas. Suppliers were impressed with his willingness to listen rather than quickly announce yet another new strategy.

It's too early to tell whether Viacom's latest strategy—and CEO—will fix what ails Blockbuster. But with its prime store locations and brand name, some think the company will indeed bounce back. "When I left, it was a great com-

studios to give Blockbuster a price break—and failed

as a key executive at Wal-Mart Stores Inc. But while shoppers don't care much about which company makes them tube socks, they do care about the movie they take home. "You can threaten Huggies to the wall and threaten it go with Pampers," says Polygram Video President Bill Sondheim. "You can't do that with *Jerry Maguire* or *Independence Day*," Fields declined comment.

When an appeal from Redstone didn't convince the studios to give Blockbuster a break. In June, the mogul flew to Los Angeles to meet privately with the executives in charge of video sales at the

chandise was a bad move when it tried—and abandoned—the strategy in the early 1990s. "It didn't work then, and it doesn't work now," a longtime franchisee says. "Why Viacom would try this again is a mystery to me."

Blockbuster's focus is now back on video rentals. It ditched its heavily promoted "One World. One Word: Blockbuster" tag line, re-adopted the old "Make It a Blockbuster Night," and put the brakes on store expansion. Piloting this latest strategic shift is Antioco, who was tapped in June to replace Fields. Most recently chief of PepsiCo Inc.'s Taco Bell unit, Antioco has spent

pany," says former Blockbuster CEO Berrard, a protégé of former Blockbuster Chairman H. Wayne Huizenga who departed to rejoin his mentor in early 1996. "I still believe it is." But analysts say that once the latest management team comes up with a new strategy, it will take a year or 18 months to have an impact on results. Given Blockbuster's recent history, the company could have changed course several times by then.

By Stephanie Anderson Forest in Dallas, with Gail DeGeorge in Miami, Kathleen Morris in Las Vegas, and bureau reports

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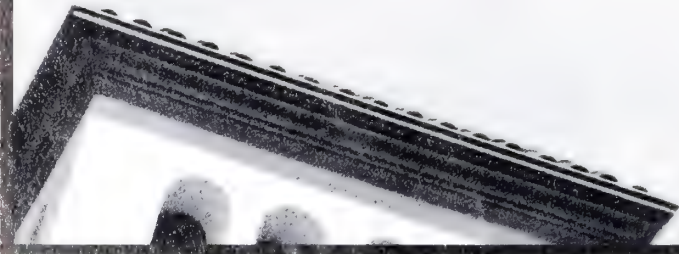


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EDITED BY AMY DUNKIN

BUYING A CAR? TAKE A SPIN ON THE NET

When Buick recently doubled the rebates on its Riviera, to \$3,000, Jim Harper hoped he would see lots of new shoppers in the Van Nuys (Calif.) showroom of Craig Buick, where he's sales manager. No such luck.

"I haven't gotten anybody out who has heard of the rebate," Harper reports.

As midsummer arrives, the competition to catch consumers' eyes with rebates and other come-ons is heating up even as car sales have cooled. Despite fair sales of its flagship Taurus, Ford, for example, recently boosted its rebate by \$500, to \$1,500. "The deals on automobiles right now are much greater than a year ago," says Ron Pinelli, president of Autodata Corp., an industry consultant based in Woodcliff Lake, N.J., that tracks prices and rebates.

CUTTING THROUGH. For car shoppers, that spells opportunity. But nice as the deals may be, rebates and cut-rate

loans hardly make it easy to find the best values. "Some of these programs are so confusing that dealers don't understand them," says Pinelli.

To help you cut through the clutter, BUSINESS WEEK asked Autodata and auto-information publisher Edmund's Publishing Corp. to gather key price information on 16 of the nation's best-selling vehicles (table).

Actual prices of the 16 models may vary among regions, reflecting local supply and demand. And the table focuses only on the nation's most popular models as they're commonly equipped. Just the same, with these data, plus more available on the Web or via a toll-free call, you'll be well on your way toward getting a good price on a new car.

It's no surprise that you'll find the best deals on cars "that are overpriced or aren't selling," says Edmund's Editor-in-Chief Christian Wardlaw. Some of these are the older-design Mercury Villager minivan (\$2,000 cash back) and the Chrysler LHS (\$1,500). Next to foreign carmakers, who are enjoying stronger volume, domestic makers are eager to deal,

particularly Chrysler and Ford.

The most painless way to start your hunt for a car is on the Internet, which allows you to narrow the field before you start taking test drives and battling dealers. Microsoft's CarPoint site (carpoint.msn.com) is a good place to start. It presents in neat and stylish form the basic dope on engines, options, crash performance, and fuel economy. One unusual feature: videos that display vehicle interiors.

PRIMARY NUMBER. Before setting off for a showroom, you need a pretty good idea of how much you should pay for the one or two models you're considering, equipped the way you want. For that, head for some other Web sites, each of which has different strengths.

Kelley Blue Book (www.kbb.com) can give you an authoritative read on the primary number you need: the dealer invoice price (including destination charges, which aren't negotiable), or what the dealer paid for the

basic car wholesale. To add the invoice prices (optional equipment you can find all of which are available at the Kelley site. We checked out a Cadillac DeVille with California-approved emissions equipment, a moon roof, a top-end stereo system and found an invoice price of \$39,340—nearly 10% below the \$43,170 sticker price, MSRP (manufacturer's suggested retail price).

But don't stop there. Dealers usually receive further discounts in one form or another from the auto manufacturers. That's how car lots can advertise prices "below invoice" and it gives you more

Where the Deals Are

MID-SIZE CARS

MODEL	TRIM LEVEL	STICKER PRICE*	INVOICE	HOLD-BACK**	REBATE†	INCENTIVE LOAN RATE‡
HONDA ACCORD	LX 4 Dr. 5-Spd.	\$18,585	\$16,469	2%	None	None
TOYOTA CAMRY	LE 4 Dr. Auto	\$20,348	\$17,866	2%	None	None
CHEVY LUMINA	LS 4 Dr.	\$19,695	\$17,876	3%	\$750 or	3.9% 12-48 mo.
FORD TAURUS	GL 4 Dr.	\$19,535	\$17,887	3%	\$1,500	4.8% 12-48 mo.; or 5.9% 49-60 mo.

LUXURY

MODEL	TRIM LEVEL	STICKER PRICE*	INVOICE	HOLD-BACK**	REBATE†	INCENTIVE LOAN RATE‡
CADILLAC DEVILLE	V8 4 Dr.	\$37,660	\$34,515	3%	None	None
LINCOLN TOWN CAR	Exec. Series	\$37,950	\$33,560	3%	\$5,000 or	1.0% 12-48 mo.
LEXUS LS 400	V8 4 Dr.	\$53,395	\$45,375	3%	None	None
MERCEDES E420	V8 4 Dr.	\$50,495	\$44,005	2%	None	None

N.A.: Not available; *Includes destination charges; **Discount to dealer from manufacturer; †May vary by region





gain. These discounts commonly called "hold-back," and usually they're a percentage of the sticker price (not including the tax at charge). The DeVille, for example, would have had the dealer a holdback amount from Cadillac of \$1,275, or 3% of the invoice price. Take that amount off the invoice price to find a car's true break-even point, and from there also take any rebates offered to consumers by the carmakers. Edmund's Web site (www.edmunds.com) lists the holdback rates for most manufacturers and also offers an auto-understand descrip-

tion of how to use the information. Edmund's suggests that once you find the dealer's actual cost, add perhaps 5% for other expenses such as local advertising that dealers must pay, not to mention a profit. "Your goal should be to pay 2% to 5% over the dealer invoice," Edmund's advises, "not the 8% to 10% the dealer wants you to."

ALL THE FIGURES. Using advice and data from these sites, Orange County (Calif.) car shopper Jan Aven recently set out in search of a burgundy Jeep Grand Cherokee with leather seats and gray trim, a compact-disk player, and antilock brakes. "I could

tell you right down to the penny" how much the car had cost wholesale, she says.

The sticker price was nearly \$30,000, but she was intent on getting it at her target price of no more than \$27,000.

First, Aven tried her nearest Jeep dealer. "But he was thinking I was dumb," and wouldn't acknowledge that "I had all the figures." Next, she tried a buying service available through a discount retailer and got a reasonable first quote of \$500 over the invoice. But Aven hoped to do better. So she pointed her Web browser at Auto-By-Tel (www.autobytel.com), which has signed up some 1,900 dealers in North America. The dealers agree to pass along some of their savings on marketing expenses to consumers who use Auto-By-Tel. It delivers dealers serious buyers at a small cost.

Late one evening, Aven filled out a form at the Auto-By-Tel Web site, specifying the options she wanted on the Grand Cherokee. Then she clicked "Send." Early the next day, she says, a nearby Jeep dealer telephoned with a firm quote on the car near her target price, and she went ahead and closed the deal.

AutoVantage (www.autovantage.com) offers a comparable service that it formerly reserved for members of its buyer's club. It can also be

reached by phone (800 288-6826), making it a good alternative for the computerless. Still not available on the Web—and another option for people without computers—is *Consumer Reports'* auto pricing service (800 395-4400). It delivers reports by mail or fax for \$12 each, and consolidates all the key information you'd have to hunt for at several Web sites. But by fall, says Paige Amidon, manager of the service, *Consumer Reports* will have a Web page, too.

NO EXCUSE? The Internet also has helpful tools to explore your financing options. CarPoint provides a loan calculator that allows you to point your cursor at a graph and drag around variables—monthly payment amount, interest rate, loan term—to see how changing one or more affects the others. That's helpful if you're trying to decide whether it's cheaper to take, say, the \$5,000 cash rebate Lincoln is offering on its Town Car or borrow from Lincoln at just 1%.

If you're interested in leasing, IntelliChoice (www.intellichoice.com) compiles current leasing deals on most models, and has a good primer on what all that leasing gobbledygook means. AutoSite (www.autosite.com) offers a swift and very handy lease calculator.

With all the information around, there's no longer much excuse for getting burned when buying a new car. Because dealers are wising up, too, you can now strike a fair deal faster than ever.

Robert Barker

MINIVANS					
TRIM LEVEL	STICKER PRICE*	INVOICE	HOLD-BACK**	REBATE†	INCENTIVE LOAN RATE‡
LE 4 Dr.	\$25,795	\$23,289	3%	\$750	None
GL V6 3 Dr.	\$20,920	\$18,969	3%	\$1,000 or	4.8% 12-48 mo.; 5.9% 49-60 mo.
SE 3 Dr.	\$20,505	\$18,634	3%	\$750	None
V6 4 Dr.	\$22,439	\$20,361	3%	None	None

SPORT-UTILITIES					
MODEL	TRIM LEVEL	STICKER PRICE*	INVOICE	HOLD-BACK**	REBATE† INCENTIVE LOAN RATE‡
FORD EXPLORER	XLT 4WD 4 Dr.	\$26,750	\$24,213	3%	None 4.8% 12-48 mo.; 5.9% 49-60 mo.
JEEP GRAND CHEROKEE	Laredo 4WD 4 Dr.	\$28,040	\$25,448	3%	None 4.8% 12-48 mo.
FORD EXPEDITION	XLT 4WD 4 Dr.	\$30,860	\$26,992	3%	None None
CHEVY BLAZER	4WD 4 Dr.	\$24,756	\$22,453	3%	\$1,000 None

DATA: AUTODATA; EDMUND'S PUBLISHING (HOLDBACK DATA)



DOES PEPSI STOCK HAVE MORE FIZZ?

The weather's hot, and the cola wars are in full swing. Coca-Cola is charging after consumers with its Incredible Summer promotion, while PepsiCo is counting on its Pepsi Stuff giveaways to help it win fans. But far from the beaches and ball fields, the two beverage giants are waging a different kind of battle—for a bigger share of investors' money. In these cola wars, investors must decide whether Coke, Pepsi, or maybe a combination of the two will add fizz to their portfolios.

A SODA PLAY. For years, whenever investors wanted to dip into beverage stocks, Coke was the first company that came to mind. The Atlanta-based soft drink giant's per-share profits have grown about 18% annually over the past five years, and analysts predict it can deliver similar returns over the next five. Investors think such assured growth is worth more than

40 times earnings. Meanwhile, many investors have viewed Pepsi with disdain, trading its shares for a fraction of Coke's multiple (table). While it's a leader in salty-snack food with its Frito-Lay brands, it has remained No. 2 in beverages and a dog in the restaurant business.

Eventually, that message got through to management. On Jan. 23, PepsiCo announced it would become more of a true soft-drink play by spinning off its Taco Bell, Pizza Hut, and KFC restaurants into a separate company. The stock jumped 3%, to 35½, on the news. "A year ago, it was clear Pepsi was having problems and Coke was the one you had to be with. Now we're taking a second look at Pepsi," says John Wilson, portfolio manager at State Street Research Investment Trust, which owns 4.7 million Coke shares.

A post-spin-off Pep-

si may be worth the extra glance. The move allows management to focus attention and capital on a beverage business that has had, over the past five years, operating margins of about 12.6% and pretax profit growth of 9%. In the U.S., Pepsi holds about a 31% market share, vs. Coke's 43%. Its Mountain Dew brand has enjoyed success, with super-market volume growing 10% last year. But analysts caution that while the spin-off levels the playing field,

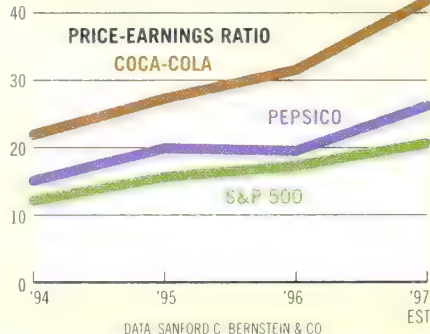
Coke and Pepsi operate their beverage businesses quite differently. Unlike Coke, which mainly sells concentrate to independent bottlers, Pepsi owns its bottling and concentrate operations. Analysts say this makes Pepsi more vulnerable to price wars that put pressure on its bottling margins. So when Pepsi announced it would form a separate management unit for its domestic bottling operations, Wall Streeters grew optimistic, figuring the next step is a spin-off. Pepsi says it has no plans to cut loose its bottlers.

But Pepsi still has to face the challenge of its international beverage business. While Coke generates about 70% of its sales abroad, Pepsi's international sales make

up only 20% of revenue. And Coke competes fiercely overseas. Last August, Coke successfully wooed Pepsi's Venezuelan bottler, leaving Pepsi with no distribution in a market it had dominated for years. Rather than go head-on abroad, Pepsi is building aggressively in emerging markets such as China and India, where Coke's ubiquitous brand is not as entrenched. "They're taking a more guarded approach, and that's smart," explains K. Timothy Swann, an analyst for A.G. Edwards & Sons. **SNACKS.** Pepsi investors get snacks to go with their beverages. The company's Frito-Lay unit, which makes more than 50% of the company's snack market, will make more than half of Pepsi's profits after the restaurant spin-off is concluded by year's end. While the domestic snack category has averaged a 2.4% volume growth over the past five years, Frito-Lay managed to expand its volume an average of 9% a year. Strong distribution systems and low manufacturing costs for successful new products such as Baked Lays potato chips have also cemented its leadership position. Analyst William Pecoriello of Salomon Smith Barney says Frito-Lay profits should grow by 20% over the next two years, while the planned introduction next May of fat-free potato and tortilla chips should go smoothly.

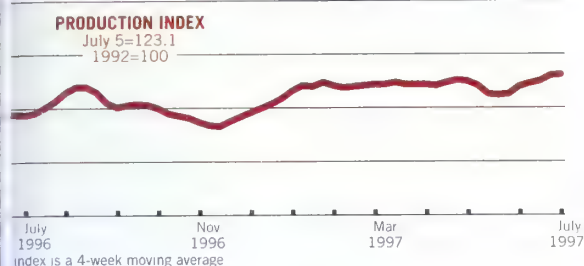
Despite the good news, Pepsi still has a long way to go to catch up with Coke. But if the market declines, investors may not care to pay such a rich premium for Coke's growth. "Coke is a minnow stock, but beware the mindless. At this point, it has to maintain its lead," says John N. Wellington, Managing Director at Wellington Management. To Pepsi's advantage, being No. 2 means it has room to expand and a more affordable price. *Nicole E.*

TRYING TO CATCH COKE



PRODUCTION INDEX

Change from last week: 0.1%
Change from last year: 3.1%



Production index edged up slightly during the week ended July 5. But calculation of the four-week moving average, the index slipped to 123.9 in the previous week. Seasonally adjusted output of autos and trucks were down sharply, but that partly reflects plant closings during the tire weekend for the Fourth of July holiday and for model changeovers. And crude-oil refining production were up significantly for the week.

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PRICING INDICATORS

	LATEST WEEK	WEEK AGO	YEARLY % CHG
STOCK PRICES (7/10) S&P 500	913.78	916.92	41.4
LIBOR RATE BOND YIELD, Aaa (7/11)	7.19%	7.35%	-7.0
INDUSTRIAL MATERIALS PRICES (7/11)	105.5	105.9	-0.8
LESS FAILURES (7/4)	NA	NA	NA
ESTATE LOANS (7/2) billions	NA	NA	NA
VEHICLE SUPPLY, M2 (6/30) billions	\$3,923.8	\$3,919.3r	4.7
UNEMPLOYMENT CLAIMS, UNEMPLOYMENT (7/5) thous.	377	337	2.7

Sources: Standard & Poor's, Moody's, Journal of Commerce (index: 1990=100), Reserve, Labor Dept.

INTEREST RATES

	LATEST WEEK	WEEK AGO	YEAR AGO
MUTUAL FUNDS (7/15)	5.47%	5.46%	5.20%
COMMERCIAL PAPER (7/16) 3-month	5.57	5.58	5.55
LIBOR RATES OF DEPOSIT (7/16) 3-month	5.60	5.60	5.54
MORTGAGE (7/11) 30-year	7.67	7.83	8.55
FIXED RATE MORTGAGE (7/11) one-year	5.78	5.85	6.15
LIBOR (7/11)	8.50	8.50	8.25

Sources: Federal Reserve, HSH Associates, Bloomberg Financial Markets

Data in the production indicators are seasonally adjusted in computing the BW index (chart); other components (estimated and not listed) include machinery and defense equipment. 1=Western Wood Products Assn. 2=Southern Forest Products Assn. 3=Free market value NA=Not available r=revised NM=Not meaningful

THE WEEK AHEAD

GREY-HAWKINS TESTIMONY

July 22 ▶ Federal Reserve Chairman Greenspan will appear before the Banking Committee to testify on current monetary policy and present the Fed's inflation, and unemployment. Greenspan is scheduled to give his testimony before the Senate July 23.

BUDGET

July 22, 2 p.m. EDT ▶ The Treasury is likely to report a budget surplus of \$20 billion in June when quarterly tax payments are made. That's the median forecast by economists surveyed by MMS International,

one of The McGraw-Hill Companies. The expected June surplus would push down the deficit thus far in fiscal 1997 to just \$20 billion, compared with \$74 billion in the first nine months of fiscal 1996. The surplus in June, 1996, was \$34.3 billion. Thanks in large part to record tax payments, Washington's budget gap is expected to shrink to about \$70 billion in 1997, vs. \$107 billion in fiscal 1996.

UNEMPLOYMENT CLAIMS

Thursday, July 24, 8:30 a.m. EDT ▶ Initial claims for state unemployment benefits likely fell back to about 340,000 for the week ended July 19. Claims shot up by 40,000, to 377,000, in the week of July 5. Layoffs

because of model changeovers in the auto industry contributed to the jump.

DURABLE-GOODS ORDERS

Friday, July 25, 8:30 a.m. EDT ▶ The MMS survey forecasts that new durable-goods orders increased by 0.8% in June, recouping the 0.7% drop of May.

EXISTING HOME SALES

Friday, July 25, 10 a.m. EDT ▶ Existing homes probably sold at an annual rate of 4.16 million in June, says the MMS report. In May, resales increased 4.4% to 4.24 million. Housing demand has held up well this year, thanks to growing incomes and high consumer confidence in the economy's future.

PRODUCTION INDICATORS

	LATEST WEEK	WEEK AGO	YEARLY % CHG
STEEL (7/12) thous. of net tons	2,056	2,080#	4.9
AUTOS (7/12) units	37,121	6,394r#	NM
TRUCKS (7/12) units	9,525	13,702r#	NM
ELECTRIC POWER (7/12) millions of kilowatt-hrs	69,507	69,519#	-1.5
CRUDE-OIL REFINING (7/12) thous. of bbl./day	14,914	14,762#	5.4
COAL (7/5) thous. of net tons	17,531#	20,412	7.4
LUMBER (7/5) millions of ft.	349.7#	508.5	16.5
RAIL FREIGHT (7/5) billions of ton-miles	22.1#	26.5	2.8

Sources: American Iron & Steel Institute, Ward's Automotive Reports, Edison Electric Institute, American Petroleum Institute, Energy Dept., WWP1, SFP2, Association of American Railroads

PRICES

	LATEST WEEK	WEEK AGO	YEARLY % CHG
GOLD (7/16) \$/troy oz.	319.500	317.300	-16.7
STEEL SCRAP (7/15) #1 heavy, \$/ton	143.50	138.50	7.5
COPPER (7/11) ¢/lb.	111.1	116.6	18.6
ALUMINUM (7/11) ¢/lb.	75.0	76.0	7.1
COTTON (7/12) strict low middling 1-1/16 in., ¢/lb.	70.86	72.10	-7.4
OIL (7/15) \$/bbl.	19.43	19.34	-12.6
CRB FOODSTUFFS (7/15) 1967=100	239.60	235.45	-14.4
CRB RAW INDUSTRIALS (7/15) 1967=100	332.75	332.51	-0.1

Sources: London Wednesday final setting, Chicago market, Metals Week, Memphis market, NYMEX, Commodity Research Bureau

FOREIGN EXCHANGE

	LATEST WEEK	WEEK AGO	YEAR AGO
JAPANESE YEN (7/16)	116.10	112.82	108.48
GERMAN MARK (7/16)	1.80	1.76	1.49
BRITISH POUND (7/16)	1.67	1.69	1.54
FRENCH FRANC (7/16)	6.07	5.95	5.06
ITALIAN LIRA (7/16)	1745.8	1717.8	1517.8
CANADIAN DOLLAR (7/16)	1.37	1.37	1.37
MEXICAN PESO (7/16)	7.916	7.885	7.625
TRADE-WEIGHTED DOLLAR INDEX (7/16)	104.9	103.2	97.2

Sources: Major New York banks. Currencies expressed in units per U.S. dollar, except for British pound in dollars. Trade-weighted dollar via J.P. Morgan



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Index to Companies

This index gives the starting page for a story or
feature with a significant reference to a company.
Most subsidiaries are indexed under their own names.
Companies listed only in tables are not included.

A

ABN AMRO Chicago 32
AeroAstro 89
A.G. Edwards (AGE) 108
Alcoa (AA) 42
Ameritech (AIT) 10
Apple Computer (AAPL) 30,
32
AST Research (ASTA) 30
AT&T (T) 6, 28, 33, 84
Autodata 106
Automatic Data Processing
(AUD) 73

B

Bank of America (BAC) 4
Baron Asset (BARAX) 73
BBN 84
Bear Stearns (BSC) 66, 73
Beaver Creek 73
Bell Atlantic (BEL) 10
Bell Atlantic Nynex 28
Bell Atlantic Nynex Mobile 10
BellSouth (BLS) 6, 18
Benetton Group (BTON) 36
Bernstein (Sanford C.) 101,
108
Blockbuster 101
Boeing (BA) 89
Boston Celtics 13
Breckenridge 73
British
Telecommunications(BTY) 2
8, 84
Burger King (GRM) 54

C

Cable & Wireless (CWP) 84
Cablevision Systems
(CVC) 58
Caesars World 42
Calvin Klein 76
Campbell Soup (CPB) 42
Cantor Fitzgerald 4
Chase Manhattan (CMB) 73
China Lucky Film 48
Chrysler (C) 30, 106
Cisco Systems (CSCO) 84
Citicorp (CCI) 73
Citicorp Securities 84
Coca-Cola (KO) 42, 108
Colgate-Palmolive (CL) 42
Columbia Pictures (SNE) 84
Commerce International
Merchant Bank 66
Compaq Computer (CPQ) 30
Composite Growth & Income
Fund 101
CompUSA 30
Concepcion Industries 66
Continental 46
Craig Buick 106
Credit Suisse First Boston 84

D

Daimler-Benz (DAI) 46
Dataquest 30

Dell Computer (DELL) 30
Deutsche Morgan Grenfell 24
Deutsche Telekom 84
Developer Cyberonics 42
DFS Group 76
Donnelley (R.R.) (DNY) 33
Douglass Bancorporation 35
DuPont (DD) 32

E

Eastman Kodak (EK) 33, 48
Edizione 36
Edmund's Publishing 106
Electrocom 6
Electronic Data Systems
(EDS) 73
Enterprise Corporation of the
Delta 35
EPL Technologies (EPTG) 73
Euromoney 42

F

Feldman Orthodontics 84
FirstCall 30
First Union (FTU) 84
Florida Crystals 42
Flo-Sun 42
Ford (F) 30, 42, 106
France Télécom 84
Fuji Photo Film (FUJII) 48
Furman Selz 101

G

Gateway 2000 (GATE) 30
General Electric (GE) 30
General Mills (GIS) 54
General Motors (GM) 42, 66,
106
Gianni Versace 76
Golden Bear Golf 4
Goldman Sachs 4, 36, 76
GTE (GTE) 84
Gucci 76
Gustav Selzer 46

H

Hard Rock Cafe 6
Hasbro (HAS) 88
Hermitage Capital 73
Hewlett-Packard (HWP) 30,
66, 84
Hilton Hotels (HLT) 42
Hollywood Entertainment
(HLYW) 101
HSBC Markets 71
Hyatt 73

I

IBM (IBM) 30
IMI SIGECO 36
ING Barings 66
Institutional Investor 42
Intel (INTC) 30, 32, 43, 84
International Data 30
International Paper (IP) 30
Internet Entertainment
Group 88
Invesco Funds Group 54

Ionics Circuits 66
ITT (ITT) 42

J

Jardine Fleming International
Securities 66
J.D. Power & Associates 84
Juno Lighting 88
Juno Online Services 88

K

Kagan Telecom 33
Karl Lagerfeld 76
Kelly Space & Technology 89
Keystone 73
Kistler Aerospace 89
Kmart (KM) 58
Knight-Ridder (KRI) 54
Kosan Biosciences 100
KPMG Peat Marwick 89

L

Legg Mason Wood Walker 28
Lehman Brothers (LEH) 4, 24
Lockheed Martin (LMT) 89
Los Angeles Dodgers 38
Louisville Development
Bancorporation 35
LVMH 76
LunaCorp 89

M

MailCode 6
Majestic Athletic 38
Martha Stewart Living
Omnimedia 58
Massachusetts Envelope 43
McGraw-Hill (MHP) 54, 66,
109
MCI Communications
(MCIC) 28, 84
McKinsey 58, 76
Media Group Research 101
Merrill Lynch (MER) 73, 76
Microsoft (MSFT) 32, 84, 106
Mitsui 76
MMS International(MHP) 109
Montgomery Securities 10
Morgan Stanley 36, 76
Morgan Stanley, Dean Witter,
Discover (MED) 66
Motorola (MOT) 33, 66

N

NationsBank (NB) 4
Network Solutions 88
News Cafe 76
News Corp.(NWS) 28
New York Yankees 38
NextWave Telecom 28
Nike (NKE) 10
Northern Business
Information 28
Norwegian Cruise Lines 73

O

Ogilvy & Mather 58

P

Pacific Telesis (PAC) 84
Packard Bell NEC 30
PaineWebber (PWJ) 42
PepsiCo (PEP) 101, 108
PGMedia 88
Pierre Cardin 76
Pillsbury 73
Pioneer Astronautics 89

Pioneer Rocketplane 89
Polo Ralph Lauren 76
PolyGram Video (PLG) 1
PostalSoft 6
Procter & Gamble (PG)
Prudential Securities 42

Q

Qwest Communications
(QWST) 84

R

Reed Elsevier 54
Reynolds Metals (RLM)
Rizzoli 76

S

Saks Fifth Avenue (SKS)
Salomon Brothers (SB)
San Diego Padres 38
Savannah Foods &
Industries 42
SBC Communications
(SBC) 33, 84
SBC Warburg 36
Sea Launch 89
Securities Data 10
Sheraton 42
Sherwin Williams (SHW)
Shorebank 35
Southcoast Capital 30
Southern Development
Bancorporation 35
SpaceDev 89
Sprint (FON) 28, 84
SRI International 10
Starter Sportswear 38
State Street Research &
Management 30
State Street Research
Investment Trust
(SITAX) 108
SunGard Data Systems
(SDS) 73
Sun Microsystems (SUN)
Sybase (SYBS) 18, 43

T

TeleChoice 28, 33
Texas Instruments (TXN)
66
Time Warner (TWX) 58
Times Mirror (TMC) 54
Total (TOT) 51
Toyota Motor (TOYOY) 1
Travelers Group (TRV)

U

United Airlines (UAL) 7
UUNET Technologies
(UUNT) 28

V

Vail Mountain 73
Vail Resorts 73
Veronis Suhler 54
Viacom (VIA.B) 101

W

Wal-Mart (WMT) 101
Walt Disney (DIS) 42
Wellington Management
Westdeutsche Landesbank
WorldCom (WCOM) 28

Y

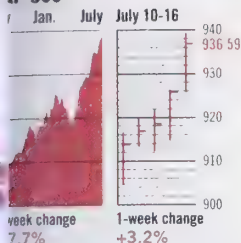
Yves Saint Laurent 76

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Investment Figures of the Week

STOCKS

S&P 500



MENTARY

it get any better than this? ed by excellent second-quarter profit reports and a bond-market rally, the Dow industrials sailed past 8000 on July 16, closing at a record 8039. That's a 1,000-point gain since Jan. 30. The Standard & Poor's stock index jumped to a new high as well. The steamiest action was in the over-the-counter market. Led by high-tech giants like Microsoft, the NASDAQ Composite gained 6.3% for the week. Bond prices rose as investors cheered the Labor Dept.'s report that consumer prices rose 0.1% in June.

U.S. MARKETS

	Latest	% change Week	Year
Dow Jones Industrials	8038.9	2.5	50.0
NASDAQ Combined Composite	1580.6	6.3	50.0
S&P MidCap 400	306.5	4.0	41.9
S&P SmallCap 600	169.1	3.6	39.1
S&P SuperComposite 1500	200.3	3.3	47.9

SECTORS

	Latest	% change Week	Year
Bloomberg Information Age	297.3	6.8	58.4
S&P Financials	105.3	2.1	65.0
S&P Utilities	202.0	0.9	5.5
PSE Technology	323.2	7.1	76.8

FOREIGN MARKETS

	Latest	% change Week	Year
London (FT-SE 100)	4964.2	4.2	36.7
Frankfurt (DAX)	4201.2	3.6	70.1
Tokyo (NIKKEI 225)	20,358.7	3.4	-4.9
Hong Kong (Hang Seng)	15,446.0	5.0	45.3
Toronto (TSE 300)	6744.8	2.6	37.1
Mexico City (IPC)	4787.4	-1.0	62.6

FUNDAMENTALS

	Latest	Week ago	Year ago
S&P 500 Dividend Yield	1.62 %	1.63 %	2.26 %
S&P 500 P/E Ratio (Last 12 mos.)	23.5	23.3	18.7
S&P 500 P/E Ratio (Next 12 mos.)*	18.8	18.6	NA
First Call Earnings Surprise*	1.87 %	4.01 %	NA

TECHNICAL INDICATORS

	Latest	Week ago	Reading
S&P 500 200-day average	784.2	778.4	Positive
Stocks above 200-day average	80.0 %	80.0 %	Negative
Options: Put/call ratio	0.45	0.49	Negative
Insiders: Vickers Sell/buy ratio	2.42	2.02	Neutral

Data: Bloomberg Financial Markets; *First Call Corp.

BEST-PERFORMING GROUPS

	Last month %	Last 12 months %
Trucking	28.2	Semiconductors 131.8
Oil & Gas Drilling	22.5	Trucking 123.8
Communications Equip.	21.7	Savings & Loans 106.0
Semiconductors	21.5	Computer Systems 104.4
Computer Systems	19.4	Invest. Banking/Bkrg. 103.3

WORST-PERFORMING GROUPS

	Last month %	Last 12 months %
Photography/Imaging	-14.5	Gold Mining -22.8
Gold Mining	-11.0	Photography & Imaging -3.3
Metal & Glass Containers	-9.6	Engineering & Constr. -0.5
Hospital Management	-6.8	Electric Companies 1.1
Oil Exploration & Prod.	-5.8	Manufactured Housing 2.1

BLOOMBERG MONEY FLOW ANALYSIS

Rebound ahead? Stocks with most significant buying on price weakness

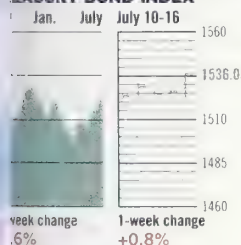
	Price	1-month change
Telebras-ADR	135	-5 1/2
Wells Fargo	267	-16 1/4
Chevron	76 5/8	-1/4
Amoco	90	-1 1/2
Bell Atlantic	72 1/8	-5 1/8
Ameritech	68 1/4	-1 1/8

Decline ahead? Stocks with most significant selling on price strength

	Price	1-month change
Intel	80 29/32	7 9/32
Microsoft	138 19/32	6 27/32
Dell Computer	141 7/16	26 1/16
Ascend Communications	53 3/8	11 1/2
Pfizer	61 1/2	5 5/16
Boeing	58 1/16	3/16

INTEREST RATES

TREASURY BOND INDEX



KEY RATES

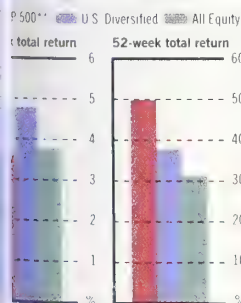
	Latest week %	Week ago %	Year ago %
MONEY MARKET FUNDS	5.16	5.17	4.95
90-DAY TREASURY BILLS	5.18	5.11	5.27
6-MONTH BANK CDS	5.18	5.18	5.03
1-YEAR TREASURY BILLS	5.49	5.53	5.77
10-YEAR TREASURY NOTES	6.18	6.25	6.84
30-YEAR TREASURY BONDS	6.47	6.56	7.03
LONG-TERM AA INDUSTRIALS	6.94	7.02	7.54
LONG-TERM BBB INDUSTRIALS	7.32	7.40	7.98
LONG-TERM AA TELEPHONES	7.18	7.31	7.87

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 31% federal tax rate.

	10-yr. bond Latest week	10-yr. bond Last week	30-yr. bond Latest week	30-yr. bond Last week
GENERAL OBLIGATIONS	4.61%	4.68%	5.18%	5.25%
PERCENT OF TREASURIES	74.58	74.93	80.00	80.04
TAXABLE EQUIVALENT	6.68	6.78	7.51	7.61
INSURED REVENUE BONDS	4.72	4.78	5.37	5.43
PERCENT OF TREASURIES	76.36	76.54	82.93	82.78
TAXABLE EQUIVALENT	6.84	6.93	7.78	7.87

MUTUAL FUNDS



EQUITY FUNDS

Leaders	Laggards
Four-week total return %	Four-week total return %
Amerind Technology D 24.4	Gabelli Gold -21.7
Van Wagoner Mid-Cap 17.7	Bull & Bear Gold Investors -19.3
Jundt US Emerging Gr. B 17.4	Midas -19.2
Van Wagoner Post-Venture 17.0	Van Eck Gold Opport. A -18.5
Van Wagoner Emerging Gr. 17.0	Invesco Strategic Gold -18.2
Leaders	Laggards
52-week total return %	52-week total return %
Lexington Troika Russia 104.7	United Svcs. Gold Shares -49.5
Fidelity Select Electronics 97.2	Bull & Bear Gold Investors -44.3
Pioneer Growth A 79.4	Morgan Stan. Inst. Gold A -42.6
Northern Technology 78.9	Lexington Strategic Invmts. -40.5
Rydex OTC 77.1	Midas -38.5

EQUITY FUND CATEGORIES

Leaders	Laggards
Four-week total return %	Four-week total return %
Technology 10.6	Precious Metals -14.0
Small-cap Growth 7.2	Japan -1.1
Mid-cap Growth 6.4	Diversified Pacific/Asia 0.0
Large-cap Growth 5.8	Natural Resources 1.0
Small-cap Blend 5.4	Latin America 1.8
Leaders	Laggards
52-week total return %	52-week total return %
Financial 55.2	Precious Metals -30.6
Technology 52.3	Japan -3.8
Large-cap Growth 45.6	Diversified Pacific/Asia 6.4
Large-cap Blend 43.2	Pacific/Asia ex-Japan 11.1
Latin America 42.0	Utilities 18.6

are as of market close Wednesday, July 16, 1997, unless otherwise indicated. Industry include S&P 500 companies only. Fundamentals, technical indicators, Bloomberg mon-

ey flow analysis, and mutual fund returns are as of July 15. For a more detailed explanation, write to us or E-mail figures@businessweek.com. NA=Not available **Vanguard Index 500 Fund

WHAT THE STRONG DOLLAR IS SAYING

Surf's up, and the dollar's washing over every currency in sight, dousing the once-mighty German mark in Europe and the Thai baht, Malaysian ringgit, Philippine peso, and Indonesian rupiah in Asia. With the trade-weighted dollar back to its all-time high, it's a return to the Superdollar that strangled economic growth in the '80s, right?

Wrong. Everything about the current dollar high is different from last time. Then, a soaring U.S. budget deficit sent interest rates up and drew in foreign money. Now, fiscal prudence and a disappearing deficit make the dollar the investment standard of choice—even over gold—by central banks, corporations, and individuals around the world. Then, the economy was sick, bloated U.S. corporations couldn't compete, and Japanese and German imports created a huge current-account deficit that had to be financed. Now, America has captured the high-tech summit, its corporations are the world's most competitive, and exports are booming. Foreign cash is pouring in to get a piece of the New Economy action.

The world is now split between two kinds of capitalism—the market-driven economies of the Anglo-Saxon countries and the more managed economies of Continental Europe and Asia. In

Europe, Germany and France can't find the political will to deregulate the economy and downsize the welfare society. In Asia, bureaucrats protect domestic companies from foreign competition while connected cronies divvy up the capitalist spoils.

On both continents, the economic model is to keep the economic status quo and spur growth by exports. Here, Germany is encouraging the German mark to decline vis-à-vis the dollar to make its exports cheaper. The new euro is expected to be a weak currency, for the same reasons. So, too, is east Asia's economic model, patterned after Japan's managed economy, in trouble. An avalanche of cheap, competing, made-in-China goods is crushing Southeast Asian exports on the low end and Korea and Taiwan are not competitive on the high end. This is forcing Thailand, Malaysia, and others to devalue their currencies against the dollar. If Southeast Asia continues to base its economy solely on low-cost exports, it will have to compete with mighty China in a losing battle for many decades to come.

In a world of bipolar capitalism, the strong dollar is sending a signal to policymakers in Europe and Asia. They should listen to the market and free their economies.

OLD DOGMAS AND THE NEW ECONOMY

These are the dog days of economic dogma. Withering in the blistering heat of the New Economy, many assumptions about the way things work are drying up and blowing away. It's not that the business cycle has been banned or recessions outlawed. They haven't. But the shape, character, and strength of the economy have certainly changed—for the better. This is the second installment in a series we call "The End of Conventional Wisdom." In the past, we have challenged accepted notions about the noninflationary rate of unemployment, the impact of raising the minimum wage, and the remarkable health of corporate profits (BW—May 12).

Here's more for the boneyard. Conventional wisdom says inflation can't actually fall when economic growth is strong and unemployment is low. Demand for goods and services, including labor, inevitably pushes up costs and prices. Well, sometimes not. With the economy running at 4% for the past year, the producer price index has declined six months in a row. That hasn't happened in the 50 years for which we have data. The core PPI is down to nearly 0% growth year over year. Consumer inflation is also decelerating. For the past six months, the overall consumer price index has been running at an astoundingly low 1.4%.

Conventional wisdom says corporations cut their capital spending late in the business cycle. Growth in capacity falls behind industrial production, prices rise, and inflation ensues. Not this time. Thanks to great corporate profits, real business spending for plant and equipment has grown three

times more rapidly than the economy over the past two years. The result? The key capacity utilization rate, instead of rising, is down from 83.9% in 1994 to 83.5% so far in 1997.

Conventional wisdom says Americans are terrible savers. Comparing current savings to current income, the official number still looks low. Yet thanks to the appreciation in the value of their equity holdings, households are now \$3 trillion richer than three years ago. Last year, mutual funds distributed \$173.7 billion in capital gains and dividends to shareholders. Throw in the rising value of homes and the spendthrift boomer appears to be a more responsible adult.

Conventional wisdom, in its supply-side version, says the economy can't grow your way out of a big budget deficit without tax cuts. But we have. First, serious spending caps were passed by Congress. Then marginal rates on income taxes were hiked at the very top. With the New Economy roaring, revenues flooded into Washington. The deficit is largely being paid down by a fast-growing economy and the rich, who pay most of the income and capital-gains taxes in the U.S.

Enough. The fact is that major changes in the dynamics of growth are detonating many conventional wisdoms. Globalization and information technologies are making companies hypercompetitive, generating solid profits that are fueling stock prices. Government statistics may not capture rising productivity. Healthy corporate profits at a time of little pricing pressure. It is the Dow, the S&P 500, and NASDAQ that are telling us that old assumptions should be challenged in the New Economy.

BusinessWeek

JUL 4, 1997

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market value
has dropped
by half. Here's
the untold tale
of what went
wrong. Can CEO
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**HOSPITAL
HOT SEAT**
An FBI probe
rattles
Columbia/
HCA page 76

BusinessWeek

AUGUST 4, 1997



OUT OF FOCUS?

Kodak's stock takes a beating as
its recovery plan falters page 30



Cover Story

66 THE SAD SAGA OF SILICON GRAPHICS

Just a couple of years ago, no computer maker was flying higher than SGI. It was big in the movies, sales were soaring, and its sexy image was the envy of the industry. But SGI execs got drunk on success. They neglected their bread-and-butter computer business, ignored basics such as marketing and inventory control, and spent lavishly. Now, the company that defined the future wonders about its own

News: Analysis & Commentary

28 THE PRICE IS STILL RIGHT

Measured by forward-looking yardsticks that reflect the changing economy, stocks have room to grow

30 A DARK KODAK MOMENT

Fuji's surprise assault helps stall the company's turnaround—and wallops its stock

32 PROFESSOR MILKEN'S LESSON PLAN

His Knowledge Universe seeks to be a big player in education, tech consulting, and training

34 COMMENTARY

The experience of a reporter's father adds to a recent study that shows how frail seniors get short shrift from HMOs

36 A BREAKTHROUGH FOR EPILEPTICS

Cyberonics' anti-seizure device could revolutionize treatment—and send the company's fortunes soaring

38 A BANK AT NEARLY ANY PRICE

Expansion-minded banks are being forced to pay big multiples of book value for attractive acquisitions

38 'DISASTER' FOR MOTOWN'S PAPERS?

After a bitter, two-year battle, Detroit's two dailies may be forced to rehire strikers in what would be a major defeat

40 COMMENTARY

Does anyone really believe that matchbox-size office cubicles promote productivity and teamwork?

42 IN BUSINESS THIS WEEK

International Business

46 SOUTH KOREA

Carmaker Kia's debt crunch signals that the crisis among the giant *chaebol* could spread to the banking sector

46 SOUTH KOREA

Lee Hoi Chung is a hard-case reformer—and he looks ready to win the presidential elections in December

51 CHINA

Incensed by Disney's Tibet movie, Beijing may be freezing the country's TV and film projects

54 GERMANY

The merger of Vereinsbank and Bayernbank creates a Bavarian behemoth—and could be a model for other mergers

56 INTERNATIONAL OUTLOOK

Latin America: Europe is dominating trade via the fast-growing Mercosur group, led by Brazil and Argentina

Economic Analysis

20 ECONOMIC VIEWPOINT

Becker: Let vouchers and market forces undo the damage wrought by government meddling in housing

22 ECONOMIC TRENDS

European joblessness and the 10-year success, higher education among multiple jobholders, confirming the value of stock buybacks

ER STORY

ON
HICS
ent wrong
company
ee made
say "gee
HEAT UP

SUDS AND STUFF

Beth Pritchard is making a real splash in the bath page 79



DON'T WORRY, BE BULLISH

Given the strong economy, the market still has room to run page 28

DEBT MESS

In Korea, the bill comes due for decades of sloppy lending page 46



MILKING THE RUNUP

Glory days on the New York Stock Exchange page 58



EISNER TALKS

The CEO offers frank insights about Disney page 73

BUSINESS OUTLOOK

long as productivity continues to gain the economy's ability to grow without inflation, Fed Chairman Alan Greenspan is likely to stay sanguine

Government

WASHINGTON OUTLOOK

In the wake of all the Republicans' eternal feuding, Gingrich is on thin ice—and so is the GOP agenda

Finance

THE BOOMING BIG BOARD

11 Wall Street, not London or Tokyo or NASDAQ, where many of the world's leading companies want their stocks listed. Under Chairman Dick Grasso, the New York Stock Exchange regained lost ground and then some—snapping up the startups that were once NASDAQ's livelihood

UNLIKELY LIFER FROM QUEENS

Dick Grasso isn't your typical New York Stock Exchange chairman

SIDE WALL STREET

INVESTMENT FIGURES OF THE WEEK

Media

73 DEFENDER OF THE MAGIC KINGDOM

Disney's chairman talks about the ABC acquisition, the disappointing box office of *Hercules*, and a succession plan

The Corporation

76 IS RICK SCOTT ON THE CRITICAL LIST?

The FBI is investigating, and Columbia/HCA's stock is tumbling. The hard-driving CEO may have made too many enemies—including his own board

People

79 BATH & BODY'S BETH PRITCHARD

The workaholic CEO has big plans for her specialty chain—\$3 billion in sales in five years and expansion abroad

Science & Technology

81 DEVELOPMENTS TO WATCH

Warp-speed computer graphics, clarifying giant video, tools for the digital painter

82 TINY PARTICLES, BIG DILEMMA

The air pollution data aren't crystal clear. So should the EPA be making rules?

Personal Business

86 INVESTING: Corporate bond yields

HEALTH: Marathonizing in midlife

Features

4 UP FRONT

8 READERS REPORT

8 CORRECTIONS & CLARIFICATIONS

14 BOOKS

Smith: *The Colonel: The Life and Legend of Robert R. McCormick*

16 TECHNOLOGY & YOU

The writer barrels down an automated highway in a car that really drives itself

93 BUSINESS WEEK INDEX

94 INDEX TO COMPANIES

96 EDITORIALS

Let the economy keep cruising
Silicon Graphics' cautionary tale
NYSE vs. NASDAQ: Consumers will win

BUSINESS WEEK ONLINE: Internet: www.businessweek.com America Online: Keyword: BW

Up Front

EDITED BY PAT WECHSLER

AIRLINE WARS

THIS GOP TAX DUEL IS AT 35,000 FEET

SPEAKER OF THE HOUSE NEWT Gingrich may be fighting off conspirators, but he hasn't lost his knack for leading a lobbying effort.

This time, the old friend of small business is on the side of the big corporations in a turbulent Hill fracas over

services, such as Southwest Airlines, is Senate Majority Leader Trent Lott (R-Miss.).

The Gingrich forces have already persuaded the Senate to drop its proposed levy on domestic legs of international routes—which would have raised taxes on the majors \$1 billion over five years. And they likely will prevail with a Gingrich-backed plan to cut the airline tax from 10% to 7.5% while imposing a \$2 per passenger fee for each leg of a flight. Analysts think this scheme would shift more of the burden

onto smaller carriers. Whatever the solution, the industry seems destined to shoulder a large chunk of the new taxes needed to offset GOP cuts—about \$3 billion extra over five years. *Mary Beth Regan, with Wendy Zellner*



GINGRICH AND LOTT: Split loyalties

whether major airlines or the small regionals should bear the brunt of planned hikes in the airline tax. The Georgian's allegiance isn't so startling, since Atlanta is home to Delta Air Lines. Defending regional and smaller national

I-WAY PATROL

APPLE'S UNLIKELY GUARDIAN ANGELS

SOFTWARE PIRATES OFTEN distribute their booty to computer users on the Net unable—or unwilling—to pay full price. But software aficionados—some of whom admit to pirating—are being unusually merciful

to founding Apple Computer. Many, in fact, not only promise to refrain from plundering but are going so far as to monitor bulletin boards to discourage postings of pirated versions of the recently released Macintosh operating system, OS8. Says Apple spokesman Rus-



sell Brady: "I've never heard of anything like this before."

Its defenders have decided that Apple must stay alive—if only to be a thorn in the side of their archenemy, William H. Gates III. "If you decide to... use a pirated version [of OS8], you'll be stating that you don't care about Apple's success, and you're also making B. Gates's life a whole lot easier," chides one hacker's posting.

To protect OS8, which hit stores on July 22 at \$99, computer hackers are setting booby traps. One electronic mischievous warns that some downloads labeled OS8 are actually computer-killing viruses. And so keelhauling evolves. *Roy Furchgott*

TALK SHOW "The recent performance of the American economy, characterized by strong growth and low inflation, has been exceptional—and better than most anticipated...."

—Federal Reserve Chairman Alan Greenspan, testifying before a House banking subcommittee



PROXY FIGHTS

OFF WITH SALLIE MAE'S HEAD?

DISSIDENT SHAREHOLDERS OF the Student Loan Marketing Assn. (Sallie Mae) appear very close to achieving the impossible: winning a proxy battle against an entrenched management.

On July 31, shareholders will elect a new board of directors. Going in, the insurgents have the support of at least five large mutual funds controlling 39% of Sallie Mae's outstanding shares. Their already impressive strength was expected to be

HOUGH: Calling for backup

bolstered on July 24 when Institutional Shareholder Services

set to make a 180-degree turn on its previous support of Chief Executive Lawrence Hough and recommend that shareholders vote for dissident candidates. Led by former Chief Operating Officer Albert L. Lord, the dissidents have been demanding a more aggressive push as Sallie Mae privatizes from being a quasi-governmental—although publicly traded—entity that buys student loans from banks for its own portfolio or for resale to investors.

In recent days, Hough pulled out all stops defending his turf—even persuading John Neff, the legendary Vanguard Group fund manager, to come out of retirement and join his management-backed slate. He has vowed to resign if his slate is elected and has hinted at a further shakeup of top management. *Dean F...*

BELLY FLOPS

A SLIPPERY HOCKEY DEAL

JOHN SPANO'S \$165 million purchase of the New York Islanders hockey team was unraveling long before his arrest July 23 on charges of bank and wire fraud—in fact, before the deal even closed.

In early April, Fleet Bank went to closing on an \$80 million loan to the 33-year-old businessman. There was one problem, according to lawyers involved in the case: The bank never received the \$7.6 million Spano was to put on reserve to cover future interest payments.

The team's owner, John Pickett, should have been paid \$16.8 million that day as



ISLANDERS: No sale

well. He signed off on the deal anyway, taking Spano's word that the money would be forthcoming. After all, Spano was the owner of Bison Group, a profitable heavy equipment leasing company, and had recently missed a payment on his mansion.

It is unclear when Fleet management discovered that Spano never paid up. The source claims it did not catch on until June. Fleet would not comment, but a spokesman did confirm that the bank only began demanding the money in early July. *Jeanne D...*



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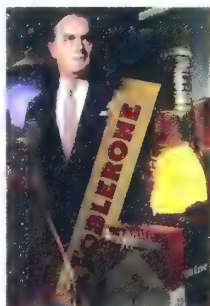
Up Front

AFTERLIVES

WAS THIS TOBACCO CEO AHEAD OF HIS TIME?

MICHAEL MILES MAY NO longer be chairman of Philip Morris, but in at least one way, his legacy lives on. In 1994, the company's board ousted nonsmoker Miles, perceiving him to be a less-than-forceful advocate for cigarettes. His replacement: pro-tobacco hard-liner Geoffrey Bible, who is now a key player in the industry's proposed deal with anti-tobacco forces.

Ironically, however, Bible may now simply be carrying out, albeit unintentionally, his maligned predecessor's vision. Despite the lack of success of lawsuits in the early '90s, Miles says that as CEO, he had already begun to discuss with Philip Morris' inner executive circle the notion of a comprehensive settlement. At the time, he felt



MILES in CEO days

that some kind of resolution would have brought a degree of certainty to the industry. "Every time there is a big suit, Wall Street takes a deep breath," Miles says. What stopped Miles and Philip Morris was an inability to identify a group powerful enough with whom to negotiate. Philip Morris declines to comment.

So how big a believer is Miles in tobacco's future? He sticks to the industry mantra that cigarettes are a legal product with expansion possibilities abroad. Still, he isn't exactly putting money where his mouth is: Last year, Miles exercised most of the 900,000 Philip Morris stock options that he received as part of his \$18 million golden parachute.

Josh Kaufman

THE BOARDROOM

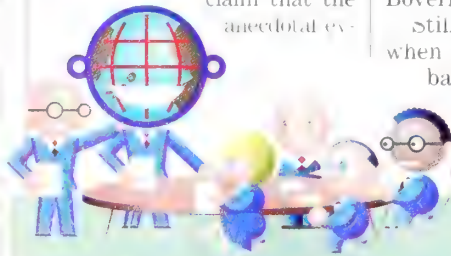
FOREIGN ACCENTS WELCOME

IN THIS GLOBAL AGE, U.S. corporations are seeking directors who bring an international perspective. Although no good numbers exist, headhunters such as Hendrick & Struggles' Theodore Jadick claim that the anecdotal ev-

idences are in particular demand. Among the more prominent appointees over the last year: Hong Kong native Christopher Cheng, chairman of Wing Tai Holdings; to W.K. Grace's board; Jan Leschly, a Dane who heads drugmaker SmithKline Beecham, to American Express; and Swede Percy Barnevik of Switzerland's ABB Asea Brown Boveri to General Motors.

Still, companies prefer it when the execs are U.S.-based, says Russell Reynolds' John Hawkins. Take Robert Lutz, Chrysler's vice chairman—a recent appointee to Silicon Graphics' board. He's Swiss-born, but doesn't require a Concorde ticket to get from Detroit to Silicon Graphics' Mountain View (Calif.) headquarters.

Lisa Sanders



idence shows companies are looking not only for directors who have worked overseas but also for those who were born there, too. Asian candi-

DRAWN & QUARTERED



ARMS BAZAAR

A GHASTLY INFLATION IN CAMBODIA

IN CAMBODIA, WHERE MORE than a million people died during Pol Pot's reign, violence comes easy. Yet arranging a murder isn't as cheap as it once was. Today, for \$1,500, a young man will agree to smash in a designated victim's skull with a metal pipe in a motorbike drive-by. Just two years ago, such an attack would have cost \$200. But with higher standards of living, particularly in Phnom Penh, a potential killer needs more incentive. No longer needing money for food and shelter,

Cambodian hit men today seeking the finer things in life. "Now, \$1,500 is the price of a new Honda 500cc motorcycle," says one prominent Cambodian.

The price of weapons has gone up, too. At the downtown Phnom Penh market where automatic weapons, lar-



GUNS are pricier

grenades, and land mines are available alongside the goods, the cost of a used AK-47 has gone from \$1,000 two years ago to \$85. Black market weapons are in scarce because Cambodia no longer allows its citizens to purchase guns to protect themselves. Participants in Cambodia's civil war. Compared with the U.S., it's still a bargain. In Dallas, an AK-47 would cost \$3,000.

Sheri Phillips

THE BIG PICTURE

9 to 5—AND THEN SOME

It's the boon—or curse—of an exuberant economy. Manufacturing workers are piling up O.T. Here's why: labor shortages in some industries and the preference among many employers to pay time-and-a-half rather than hire and train new workers.



DATA: BUREAU OF LABOR STATISTICS *FIRST HALF

FOOTNOTES Average cost of compact disk, 1986: \$17.55; 1997: \$12.70

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**'PERHAPS WE NEED
A FEW MORE MICROSOFTS'**

Whatever you might think about Bill Gates or Microsoft Corp., without someone to show the way, most of our telephone and cable companies would still be sending out news releases about planned future meetings to discuss their possible future offerings ("Bill Gates, the cable guy," News: Analysis & Commentary, July 14). Microsoft gets things done. Left to their own devices, the Telecommunications Inc. and Bells of the world would continue as dinosaurs wallowing in the low-tech tar pits. Come to think of it, perhaps we need a few more Microsofts.

John C. Schuler
Portland, Ore.

John C. Schuler
Portland, Ore.

SINCE WHEN WAS LEISURE A LOW LIVING STANDARD?

In "If Europeans Worked More..." (Economic Trends, July 14) you reason that Europeans have a lower living standard than people in the U.S. because they "put in shorter work weeks, and enjoy longer vacations." Say, I think we need a new definition of how that there standard of living is calculated.

David S. Smith
Annapolis, Md.

DON'T FREEZE OUT ALTERNATIVES TO CFCs

The U.S. Environmental Protection Agency, in combination with other governmental agencies, has been working hard to combat illegal imports of chlorofluorocarbon refrigerants, and we appreciate your informing your readers about this issue ("The black market vs. the ozone," *Environment*, July 7).

However, you say the cost of retrofitting older cars to use CFC alternatives can be as high as \$1,200 and that recharging a vehicle with CFCs costs about \$80. In fact, the vast majority of retrofits can be performed for \$250 or less. And the \$80 you cite to recharge a vehicle might cover the cost of the refrigerant alone, but not include the cost.

Business Week

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AUGUST 4, 1997 (ISSN 0007-7135)*** 3538

CORRECTIONS & CLARIFICATIONS

"The black market vs. the ozone" (Environment, July 7) incorrectly identified replacement refrigerant for car air conditioners as HCFC 134a. The correct name is HFC 134a.

of labor associated with the recha

The article also fails to mention that converting to a CFC substitute will save the vehicle owner money in the long run, because recharging a vehicle with an alternative is less expensive than recharging with CFCs. The savings from choosing to convert will continue to increase as CFC supplies dwindle and prices escalate over the next few years.

Christine Dill

Policy Ana

Environmental Protection Agency
Washington, D.C. 20460

'VALUE AT RISK' CAN PUT RISK BACK INTO MANAGEMENT

The quantification of "value at risk" is no doubt an important and useful concept when properly applied and appropriately used ("Taking the angst out of taking a gamble," Finance, July 14). But in the hands of those who understand little about the nature of "implied" volatility and confidence levels, many will fall victim to the false sense of security that compressive statistical programs promote. Inasmuch as this serves to distance management from more intuitive qualitative judgments, the methodology itself creates a whole new level of risk.

Clay Caldwell
CLA Financial
Chicago

SBC IS SPENDING BIG BUCKS TO INVITE LOCAL COMPETITION

If SBC Communications Inc. is "not in the race" to open local phone networks and markets to competition, as Peter Strom claims ("Why SBC shouldn't be the first Bell in long distance," *News: Atlanta*),

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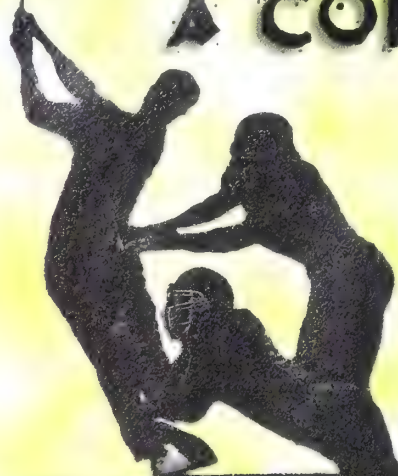
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Readers Report

& Commentary, July 21), maybe it's use we are so far ahead of the pack. By the end of this year, SBC Communications will spend \$1.2 billion on—devote 4,000 employees to—opening telephone networks to local competitors, in full compliance with the communications Act of 1996. No other company in any industry has ever tried so much to invite competitors to their customers. We have signed over 170 agreements with competitors even states allowing them to use networks. The only thing stopping us from providing local service is our own commitment to competition in the less lucrative local marketplace. When it comes to complaints that SBC Communications is somehow hindering competition in the local market, our while competitors are just arguing.

James D. Ellis

Senior Executive Vice-President
and General Counsel
SBC Communications Inc.
San Antonio

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CALL OFF THE SMOKE POLICE

There is only one major flaw in Paul Raeburn's logic in "Saving lives doesn't have to cost a bundle" (News: Analysis & Commentary, July 14): Smokers choose to start smoking, and they choose to stop or continue smoking. Not only are smokers aware of the health risks of their habit, studies show that they overestimate the risks.

In the case of little Jessica, she did not choose to be trapped underground and was not aware of the risks she was taking in her play. Patients under the knife do not choose to contract AIDS because sterile conditions are not maintained. Women over 50 should be made aware of the risks of breast cancer and of the benefits of mammograms, but they should not be taxed heavily or socially ostracized in an effort to coerce them to have mammograms.

Certainly adult smokers should have those same rights and choices, even though Raeburn and the federal government seem to think they shouldn't. If we begin trying to protect all adults from potentially risky behavior, we will not only bankrupt our nation, but we will live in a totalitarian state, which for most Americans is no life at all.

Wanda Hamilton
Miami Lakes, Fla.

THE EXPORT-IMPORT BANK CARRIES ITS WEIGHT

Your article "Dogged by Donorgate" (Finance, June 30) should have been titled "The system works: diligent Ex-Im staffers save taxpayer dollars by rejecting questionable risks." The Ex-Im underwriters are extremely deliberate in their approval process. If you try to exert undue influence from above, you will find that management generally will not second-guess the underwriters' decisions.

Our clients are mostly small- and middle-market U.S. manufacturers, whose export businesses have grown in direct relationship with their use of export credit insurance and other Ex-Im services. There is no evidence of "corporate welfare" in our portfolio.

Ex-Im is far from perfect, but its existence is essential in an economy where exporters in other countries compete, with the support of their own governments' export credit agencies, in emerging markets against U.S. companies.

Gary Mendell
President

Meridian Finance Group
Los Angeles

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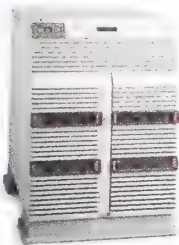
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THE COLONEL

The Life and Legend of Robert R. McCormick

By Richard Norton Smith

Houghton-Mifflin • 597pp • \$35

THIS NEWS MOGUL WAS HIS OWN BEST STORY

Whatever happened to America's screwball millionaires? Once there were giants: Railroad baron Commodore Cornelius Vanderbilt relied on séances to communicate with the dead and a seer for stock-market predictions. The puritanical Henry Ford fired employees whom his spies caught smoking and once threatened to stop all Ford auto production if prohibition were repealed.

And then there was Colonel Robert R. McCormick, publisher-editor of the *Chicago Tribune* from 1914 until his death in 1955, and master of an empire that included radio and TV stations (bearing the call letters WGN, for World's Greatest Newspaper), a fleet of ships, 7,000 square miles of timberland, prime Chicago real estate, and more.

The product of a British public school, where he got a Tory accent and numerous affectations, McCormick waged a bizarre, lifelong war of editorial invective against Britain ("the Brutish Empire"). A self-proclaimed spokesman for heartland America against New York decadence and pretension, the 6-foot 4-inch World War I vet would stride through the newsroom dressed in an English officer's jacket, boots and spurs, a polo stick in hand, and three German police dogs on a leash. Despite a fascination with war and claims to be a military mastermind, he became an ardent isolationist.

And while condemning licentious behavior in others, he persuaded the wives of two friends to divorce their husbands and wed him (though not at the same time). The spouses were appeased by large cash payments.

All this outlandishness, plus the man's intuitive business acumen, is thoroughly described in Richard Norton Smith's *The Colonel: The Life and Legend of Robert R. McCormick*. Smith, who has also written books on Thomas E. Dewey

and George Washington, is the first biographer to gain access to all of McCormick's personal and business papers. The result is a solid, balanced portrait of a fascinating, if not always admirable, media mogul.

"Bert" McCormick inherited his post at the *Tribune*, which was owned largely by his family, when other heirs faltered, and after cousin Joe Patterson left to run a sister publication, the *New York Daily News*. It wasn't long before the paper mirrored McCormick's eccentric style—which proved a draw to readers. "A great many Chicagoans despise the *Tribune*," observed John Gunther in his book *Inside U.S.A.*, "but its circulation steadily goes up...."

No doubt, many were buying it to see what the Colonel would do or say next. In the midst of the cold war, he proposed a "city-wide burning of babushkas...those regimenting rags." Once he sent a correspondent to Madison, Wis., a hotbed of liberalism, to investigate his theory that University of Wisconsin men wore lace underwear. He directed the *Trib* to use a streamlined form of spelling, replacing island, for example, with iland and freight with frate. Responding to a command to "get rabbit quote daily," the *Trib's* financial pages for a time carried the going rate for hare—all because the Colonel felt he'd been overcharged at dinner. As staffers pondered his sanity, "The newspaper became a megaphone to amplify the publisher's caprices," concludes Smith.

Sections tailored to different neighborhoods also proved a magnet for circulation, as did splashes of color, sports coverage, and such comics as "Dick Tracy" and "Little Orphan Annie," intro-

duced and syndicated by the *Trib*. There was even stuff for highbrows: Foreign correspondents included such writers as William L. Shirer, later famed for his chronicles of the Third Reich.

A Republican activist, McCormick often clashed with Democrats, particularly President Franklin D. Roosevelt. In the 1930s, the *Trib* smeared FDR, first by accusing him of being a communist. (Meanwhile, until the U.S. entered the war, the newspaper printed apologies for the Führer, despite evidence of Nazi horrors.) In 1942, a feud with FDR took a dramatic turn following a sensational *Tribune* scoop: an account of the battle of Midway, with evidence that victorious U.S. Navy commanders had known of the Japanese battle plans in advance—possibly by breaking their codes. The story, unvetted by Navy censors, caused a furor: FDR threatened to send McCormick to occupy Tribune Tower, then put the Justice Dept. to indict his bitter

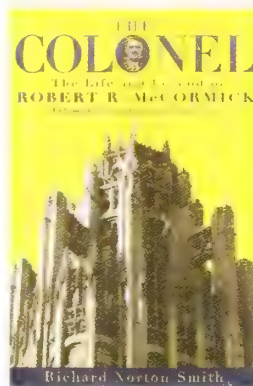
enemy under the Espionage Act. But the Navy's reluctance to publicly discuss the matter, breaking led, in the end, to a dismissal of charges against the President, it was a tactical defeat—compounded by the success of the *Trib*, which that year had a circulation of one million.

The Colonel hardly confines its focus to journalism. In fact, some may feel it dwells too much on McCormick's personal life.

Armchair psychologists, though, might find an explanation for McCormick's peculiar romances in portraits of his father and vengeful, unloving mother.

At age 75, McCormick's life ended, Smith says, as tragedy: "Marooned in the second half of the twentieth century," he was "thwarted in politics, frustrated in love, irreconcilably isolated from the political party that had been synonymous with three generations of his family." By the time of his death, from heart disease and cirrhosis, this outsize personality had become a physically shrunken man, unable to use the extra-large casket he had, years before, ordered for himself.

BY HARDY GREEN
Green is BUSINESS WEEK's Book Editor.



DURING THE COLD WAR, McCORMICK PROPOSED A CITYWIDE BURNING OF BABUSHKAS

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BY LARRY ARMSTRONG

SO THIS IS AUTOPIA

The writer barrels down an automated highway on a car that drives itself

It seems like forever that I've been reading about the imminent debut of smart cars and automated highways. They were a big hit at the 1939 New York World's Fair, I'm told, at General Motors' Futurama pavilion. I even drove a prototype Cadillac with radar braking some 25 years ago. So when a couple of opportunities came up recently to try out cars that steer, accelerate, and brake by themselves, this skeptic took the bait.

The idea behind automated highways is that by taking control of the vehicle out of the hands of the driver, the capacity of existing roads could be doubled or tripled. That's because most of today's congestion is caused by crashes, and 90% of all car accidents are caused by human error.

UNDER CONTROL. The most likely scenario for the automated highway is that you drive your car to specially instrumented lanes of a highway and "check in," much like entering a toll road. Then, the system takes control of the car until you exit, when it steers it to a transition area where you can resume manual driving.

After experimenting with two test systems, my skepticism quickly faded. I was impressed to find that much

of the technology exists today and, in fact, some of it is already in today's cars. I think we will ultimately have commercially available smart cars and automated highways. But I expect they'll face limited use over the next 30 years.

For the first test, I went to I-15 in San Diego, where the National Automated Highway System Consortium will run a Congress-mandated

series of ones and zeroes to the car, a binary code that can signal exits or the radius of an approaching curve.

Each car also has a radar sensor mounted on the front to assess the distance to the vehicle ahead. There's lots of other gear, too: Motors have to be added to steer and brake, for example, and there are two Pentium 166 computers in the trunk to control everything.

It's a pretty eerie feeling to be barreling down the highway at 65 mph in a convoy. Especially when no one's driving. We were running in a "platoon" of three cars spaced about 20 feet apart. Twelve feet is typical, and better for fuel economy—a savings of about 30%—because the closer spacing cuts

such as a blowout, the system would instantaneously hit the brakes on all of the following cars so the worst accident could be expected is a series of fender benders.

I got to see even more pieces of the system at a second preview, this one at Honda Motor's proving grounds, a 7.5-mile oval in the Mojave Desert. The carmaker has outfitted two Accords with hands-free platooning, but with a difference—it doesn't need the instrumented roadway. The cars have a camera trained on the road ahead and the computer keeps each car in the center of the lane by watching the white line between the lanes. One car drove had what's called adaptive cruise control. Instead of keeping the car at a constant

speed, it uses a rearward-looking radar to adapt the speed to changing traffic conditions.

CRUISING. I got on the track, and Honda had me out two other drivers just to make it interesting. I got up to 65 mph and set the cruise control. As I approached a slower moving car in front of me, my car slowed down and locked at its speed. When I changed lanes, the car accelerated back up to 85 mph, passing the other driver. Mitsubishi Motors already offers this as an option in



demonstration of smart-car technology in early August. The consortium has embedded magnets every four feet along the center of two reversible car-pool lanes that run for nearly eight miles. And it has decked out a fleet of 10 Buick LeSabres with magnetometers under the bumper to sense the magnets and automatically keep the cars in the center of the lane. The magnets have another role as well: Because they can be set with alternating polarities, they can send a se-

down on wind resistance. They can run cars six feet apart, but that's too nerve-racking for the passengers, said an engineer who rode in our car.

On our first run, we had a lucky break. Our radar failed, so we got to see how the system handles breakdowns. The cars talk to one another digitally through a radio link and, in this case, the lead car took control of ours and increased the spacing between us and the other vehicles. With a major catastrophe,

Japanese market.

Although pieces of this technology are starting to show up as options, the consortium estimates that it'll be 10 years from tests of completely automated highways to the general public and 20 years away from widespread use. I'm still not convinced that I'll ever be able to sit in a car on autopilot and take a nap or watch television on my commute. But the technology is creating "co-pilots" that now help to make driving easier.



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BY GARY S. BECKER

HOUSING PROJECTS AND RENT CONTROL SHOULD CRUMBLE



REMEDY:
Government meddling has made living conditions worse for many families. Let vouchers and market forces undo the damage

Most governments interfere directly in housing markets, usually by regulating rents and building publicly owned rental units. Unfortunately, rent controls and public housing often worsen living conditions for many poor and middle-class families, the very groups they are supposed to help.

Almost 1.5 million U.S. households live in projects. The buildings are typically disasters that are breeding grounds for gangs, drug use, rapes, robberies, and other crimes, and demoralize the families that live there. Notwithstanding considerable spending on upkeep and maintenance, many apartments have deteriorated to the point that they are no longer habitable. On the trip from my house to downtown Chicago, I pass large public-housing buildings that are eerily empty, despite having wonderful views, since they front Lake Michigan.

Government shouldn't be in the business of building housing for poor families, whether in large projects or smaller units scattered throughout a metropolitan area. Of course, the poor do get less space and less attractive housing in the private sector than do the middle class and the rich. But the poor also have fewer, smaller, and older cars than other families, and no one suggests that the government build cars for the poor. It is much wiser for Washington to provide sufficient income transfers to needy poor families so they can choose themselves how much to spend on housing and how much on other needs.

NEW YORK BLUES. Even if the housing that the poor get on their own is not considered acceptable, public housing is not the best solution. A much more effective system would be to provide housing vouchers that can help renters find better units in the private market. The U.S. already has a small voucher program. Vouchers give greater freedom of choice of where to live than do massive public-housing developments. Moreover, recipients tend to get their money's worth from vouchers because housing is a very competitive industry with many landlords competing for tenants, even in poor neighborhoods.

Unlike housing projects, rent controls are supposed to help the middle class as well as the poor. New York is the only major American community that has maintained ceilings on rents continuously since World War II, although Boston, San Francisco, and some other cities and towns reintroduced rent ceil-

ings during the housing boom of the 1960s. About 10% of rental units in the U.S. are now subject to price controls.

One does not have to be an economist to appreciate that landlords reduce maintenance when rents are kept artificially below market levels. As a result, the quality of the housing stock deteriorates, and landlords and tenants become embroiled in endless legal wrangles over whether buildings are adequately maintained. The sorry state of much of the rental market in New York City illustrates the consequences of rent ceilings.

WRONG BENEFICIARIES. What may be worse is that ceilings cause even the deteriorated housing stock to be allocated away from groups who most need access to reasonably priced housing. These include young people who want to start households, families that must relocate because of marital breakup, job loss, and immigrants and others who must move into a controlled housing market. On the other hand, rent controls help many wealthy households who have large apartment complexes at prices well below market levels. They tend to stay put even after their age and their changing needs contract because smaller apartments on the open market cost more.

Many past supporters of rent controls in public housing in academia and the government have changed their positions as the nature of housing projects became apparent and after learning that the decontrol of rents in cities such as Boston did not impose hardship on many poor and middle-class families. Yet the programs are in place for many years and it is difficult to eliminate them. Powerful supporters develop from politicians who represent renters with cheap housing, contractors who benefit from remodeling and maintenance work at projects, and still other groups.

A telling example is the endless political agonizing over eliminating rent ceilings in New York City. Despite intense discussion, the state legislature has not been able to abolish ceilings in its leading city. A couple of months ago, after a long struggle, it was able to decontrol a few more luxury apartments and relax minor provisions of the rent laws.

Still, the slow but steady shift of opinion away from rent control and public housing offers a ray of hope that these highly undesirable forms of government intervention in housing markets may eventually be phased out. It surely would be about time.

Gary S. Becker, the 1992 Nobel laureate, teaches at the University of Chicago and is a Fellow of the Hoover Institution

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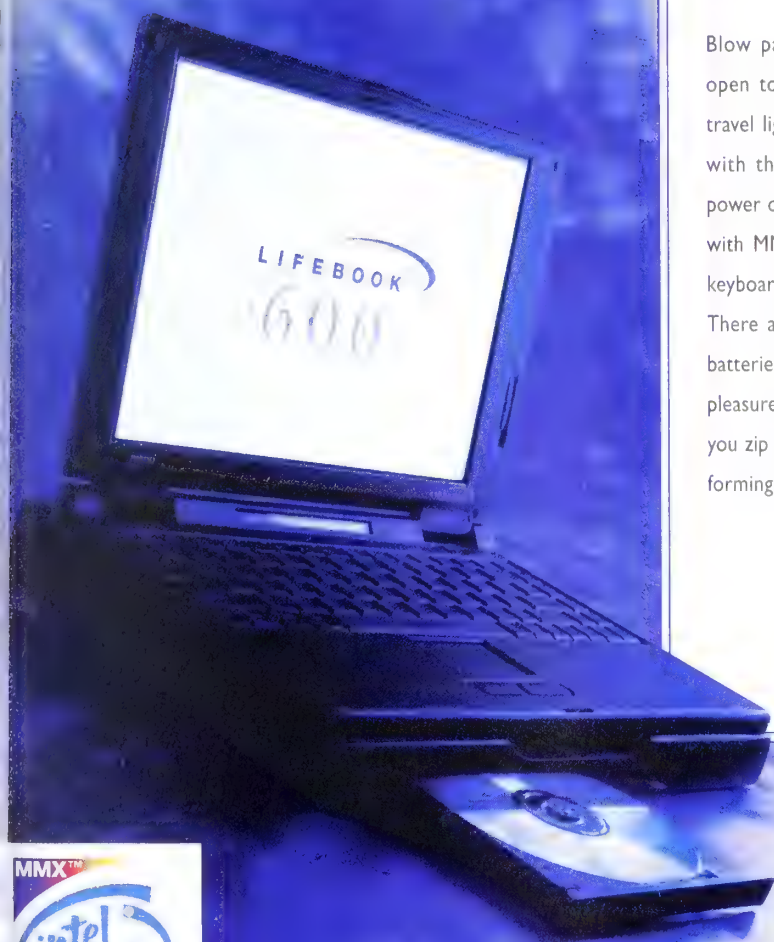
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BY GENE KORETZ

GREENSPAN'S OVERSEAS ALLIES

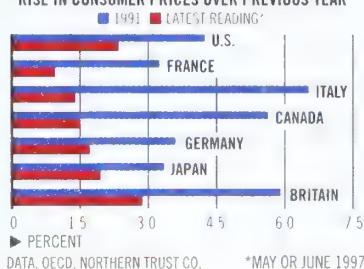
Europe's ills help ease U.S. prices

In June, the U.S. consumer price index was up just 2.3% on a year-over-year basis, while core consumer inflation (excluding food and energy prices) averaged just 2.7% last year, its lowest reading in 30 years. When you consider that many economists think current consumer inflation is overstated by a percentage point or more, that's an extraordinary achievement for Federal Reserve Chairman Alan Greenspan.

But if Greenspan is regarded as a policy genius, says economist Paul L. Kasriel of Northern Trust Co. in Chicago, "then Antonio Fazio, the head of the Bank of Italy, should be considered some

THE U.S. AND THE G-6: INFLATION FIGHTERS ALL

RISE IN CONSUMER PRICES OVER PREVIOUS YEAR



kind of central-banking Einstein." Italy's CPI, which was running about 6% over its year-earlier level as recently as early 1996, was up just 1.4% in June. Indeed, all of the other major industrial nations (G-6) except Britain have inflation rates below that of the U.S., and most have cut inflation far more dramatically than the U.S. in recent years (chart).

To be sure, America's inflation-quelling act is the only one accompanied by low unemployment. But that's precisely why Kasriel thinks it's less "miraculous" than it seems. While conceding the importance of Greenspan's leadership, he points out that a relatively ignored factor has been "the unusual weakness of other industrialized economies at this stage of the U.S. business cycle."

As the jobless rate has dropped in the U.S. during this expansion, notes Kasriel, it has risen sharply in most other industrial countries. He calculates that in the G-6 nations, it climbed by 1.3 percentage points, or 22% on a weight-

ed-average basis (weights based on economic size) from 1992 to 1996. (It has declined in Britain and Canada but is still in double digits in Germany, France, and Italy.) Since the G-6 account for 44% of world output, compared with America's 27%, their continuing anemic growth and high unemployment have tended to hold down global inflation.

For Kasriel, the lesson is clear: The real test of Greenspan's genius—and of the popular thesis that the U.S. economy may have entered a brave new world of inflation-free growth—will come when Europe and Japan adopt policies aimed at achieving robust growth.

DO BUYBACKS REALLY PAY OFF?

Yes, if the number of shares declines

Investors tend to salivate when a company unveils a buyback plan. After all, the stated intention of most managements is to raise their stock prices by reducing shares outstanding, thus boosting per-share earnings. Indeed, some market observers think the rising tide of buybacks explains the market's greatly reduced dividend yield, as companies opt to use their cash to provide investors with capital gains rather than more highly taxed dividends.

Lately, though, many investors have grown skeptical of such announcements. For one thing, many companies don't complete their repurchase plans. More important, many buy stocks with one hand and then issue low-price options covering a similar amount of stock to employees—resulting in little change in the amount of shares outstanding.

Market analyst Melissa R. Brown of Prudential Securities doesn't dispute these observations, but she believes that there's still money to be made from buybacks—if you keep track of whether companies are actually shedding shares.

Brown recently analyzed how several thousand large-capitalization, mid-cap, and small-cap stocks performed on a quarterly basis from 1978 through 1996. Each quarter, she compared the average

returns of stocks of companies that had reduced their shares by 5% or more over the prior year with the average return for their capitalization group.

The results were revealing. In the large-cap group, companies that had reduced their shares by at least 5% saw their stocks appreciate by an average 21% year over the 1978-96 period, compared with an average annual gain of 15% for the group as a whole. Among mid-cap stocks, the average annual return was 26% for the share repurchasers compared with 16.1% for the entire group. And among small-cap stocks, the difference was 22.6% vs. 15.8%.

Of course, such a strategy doesn't work for every stock. In an average quarter, reports Brown, only a little over 50% of the large-cap and mid-cap stocks with 5% share reductions led the Standard & Poor's 500-stock index. But over time, she notes, "in both down and up markets, stocks with appreciably fewer shares than a year earlier tended to produce clearly superior returns."

THOSE EDUCATED MOONLIGHTERS

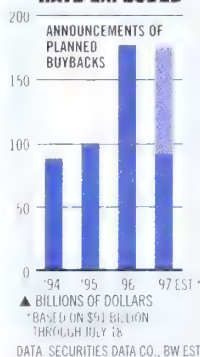
Guess who has more than one job

The conventional view is that U.S. workers who hold down more than one job do so because they need extra money. Indeed, as the number of multiple-job holders jumped by over 25%, or 2.5 million, from 1979 to 1995, the percentage of such workers citing financial reasons for working at more than one job rose from 37% to 43%. Still, a recent Labor Dept. analysis of 1995 data demonstrates that economic hardship is far from the whole story.

The study indicates that the tendency to have multiple jobs actually increased with education. While just 3% of those with less than a high school education held more than one job, the share rose to 5.1% among high school grads, 7% among college grads, and 9% to 10% among those with master's degrees or Ph.Ds. (The only exceptions were professionals, such as lawyers and doctors.)

Since earnings are highly correlated with education, it seems clear that motivations besides dire necessity are behind the increase in multiple job-holding in recent decades. Worries about future job security may be one. Another may be simply that even relatively well-paid highly educated persons welcome the chance to earn added income in an economy that values their skills.

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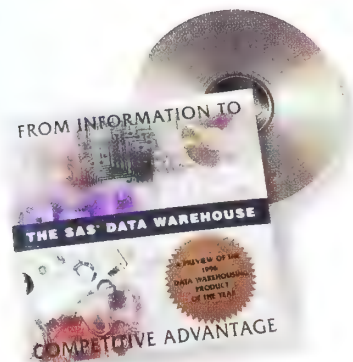
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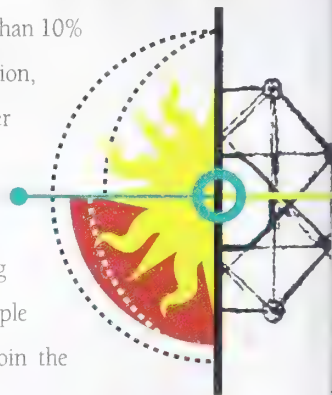
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HOW LONG WILL GREENSPAN'S GOOD MOOD LAST?

The Fed won't tighten soon—but watch those second-half growth numbers

U.S. ECONOMY

Federal Reserve Chairman Alan Greenspan had a lot to say on July 22, as he usually does when he sits down before Congress to deliver his semiannual testimony on monetary policy and the economy. Much of it was even understandable—especially on Wall Street.

In his familiar, measured drone, Greenspan sounded as if he was not ready to raise interest rates any time soon. He predicted that the economy was likely to continue on a slower growth path in the second half, and suggested that the use of new technology was enhancing the economy's productive capacity, although he said the economy's exceptional performance also reflected temporary factors that have been restraining inflation. His remarks ignited a powerful bond-market rally

A FED'S-EYE VIEW OF THE ECONOMY

CENTRAL TENDENCY PROJECTIONS	
1997	1998
REAL GDP	
-3.25%	2%-2.5%
CPI	
5%-2.5%	2.5%-3%
UNEMPLOYMENT RATE	
5%-5%	4.75%-5%

DATA: FEDERAL RESERVE

to be a full percentage point higher than projected in its February report, and it expects both inflation and unemployment to be a half-point lower. Given the 2% pace of second-quarter economic growth is generally expected when the Commerce Dept. reports on the quarter's gross domestic product, the Fed's forecast implies that second-half growth will remain in the 2%-to-2.5% range.

IT IMPLIED FORECAST

relative to what actually happens, could be critical to policy decisions in coming months. Greenspan said that if demand does not increase more slowly than it has in recent years, inflationary imbalances will emerge, and he spoke with particular caution about emerging constraints in the labor markets that could fuel a speedup in wages. With the Fed looking for continued modest growth, evidence of anything significantly stronger than that could easily oil the financial markets.

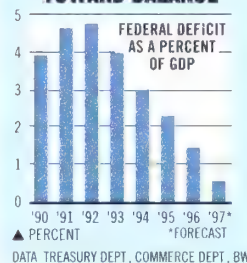
The possible irony in the market reaction to Greenspan's testimony is that the rallies in bonds and

stocks are themselves adding fuel to the economic fire. After his remarks, the benchmark 30-year Treasury bond fell to 6.41%, the lowest in seven months. That means mortgage rates and corporate borrowing costs will fall further. And the stock rally will add even more to households' wealth and sense of well-being.

Commerce's GDP report, due on July 31, will also contain revisions that may be of particular interest to Greenspan & Co. The government's supposedly twin tallies of national income and product have gotten severely out of sync in recent years. So Commerce will try to reconcile the two measures. Most analysts are betting that Commerce will end up splitting the difference: The income side of the accounts will be revised lower, and the product side revised higher.

To the extent that the product data are revised up, official measures of productivity will also be lifted. That's important because Greenspan said the trend in productivity growth is important to the economy's ability to grow at its maximum sustainable rate without generating inflation.

WASHINGTON SLIDES TOWARD BALANCE



THE SECOND-QUARTER GDP REPORT

will fit the Fed's view that the economy cooled off, after a 5.9% growth spurt in the first quarter. Final demand will show only a modest rise, after the first-quarter surge. However, the GDP numbers, combined with recent monthly data, will also offer clues about the economy's strength in the second half. And some of the evidence hints that growth will be faster than what the Fed expects.

One source of stimulus for the economy will come from the government itself. For fiscal 1998, beginning on Oct. 1, Washington plans to trim taxes well before the onerous spending cuts designed to balance the budget by 2002 are put into place. For this fiscal year, the Treasury reported a record surplus of \$54.5 billion in June, which means the deficit could total as low as \$40 billion. The deficit as a percent of GDP will drop to about 0.5%, the smallest in 23 years (chart).

The coming tax cuts will enhance already healthy household fundamentals. Job and income growth, stock-market gains, and consumer confidence all improved in

the second quarter. So, the expected second-quarter gain of just 2% in real consumer spending was most likely a pause before a rebound.

Housing may also pick up in the second half. Housing starts unexpectedly rose 4.8% in June, to an annual rate of 1.45 million. Still, after the winter's mild weather boosted residential construction in the first quarter, homebuilding in the second quarter was probably only up a bit. In the second half, however, solid consumer fundamentals and the summer fall in mortgage rates will lift housing demand further.

BUSINESS SPENDING last quarter did not slow as much as consumer outlays. Indeed, equipment spending is buoyed by the technological changes that Greenspan discussed at considerable length. It appears that equipment purchases last quarter posted a gain similar to the 12% advance in the first quarter, although business investment in structures fell last quarter. Looking ahead, business outlays will be supported by healthy fundamentals: solid demand, strong cash flow, and cheap financing in the equity and bond markets.

One key source of demand for businesses in the second half will be exports. Foreign purchases appear to have surged at a double-digit rate in the second quarter, and improving global economies mean continued strong growth. But imports are accelerating as quickly as exports (chart). The May trade deficit widened to

\$10.2 billion, from \$8.7 billion in April. As a net exports were probably a drag on second-quarter GDP. In the second half, because both exports and imports seem set to grow at similar clips, the trade deficit may show only minimal improvement.

Inventories in the second quarter appear to have grown at about the same \$50 billion or so amount as they did in the first, reflecting the quarter's continued strength in industrial production. With demand expected to improve, and with auto output already set to increase in the third quarter, inventory accumulation should continue at a high pace in the second half.

Against these forces for growth, Fed policy may be nearing a crossroads. If growth is stronger than Fed expects, will Greenspan & Co. let the economy run, betting that technology and globalization will stall inflation in 1998? Or will it tighten policy? Last week, in his speech, he said the Fed is not "conducting an experiment that deliberately prods the economy to see how far and fast it can grow." Even in murky economic speak, Greenspan's message was clear: If growth continues to pick up, the Fed is apt to take out more inflation insurance.

EXPORTS PICK UP BUT SO DO IMPORTS



COLOMBIA

HEADING DOWN THE COMEBACK TRAIL

Colombia's economy is struggling to emerge from its worst showing in two decades. Last year's government crisis, in which President Ernesto Samper was accused of taking \$6 million in campaign donations from drug traffickers, occupied policymakers so much that they neglected the economy just as growth was slowing amid fallout from Mexico's peso crisis. GDP has fallen from its year-ago level for two quarters in a row, and second-quarter growth is expected to be weak.

In response to the central bank's 10-percentage-point cut in interest rates over the past year, however, a halting recovery is under way. Credit demand is accel-

erating. Car buying is up strongly, and cement sales have stopped falling. A weak job market will restrain consumer spending, though: The first-quarter jobless rate rose to 12.7%, from 11.3% in the fourth quarter.

Private economists expect GDP growth of 2% this year, about the same as last year, with 1998 growth regaining the 5% pace of 1995.

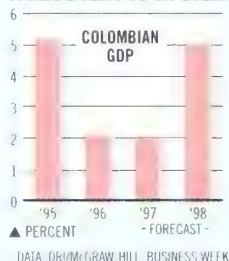
Although the coffee harvest was poor, oil output is set to rise 60% in the coming year, which alone will add about a percentage point to GDP growth. Oil accounts for 27% of exports, which will benefit generally from the weaker Colombian peso.

Uncertainty over upcoming elec-

tions, heightened by recent rural guerrilla activity and poor U.S. relations, has chilled the investment climate. The U.S. denied Colombia certain financial support for a second year, citing its inertia in fighting the drug war. The crisis also sapped so much of Samper's political capital that he cannot take strong measures to cut the fiscal deficit, expected to be 4.5% of GDP this year.

Still, with the economy mending and with inflation at an 11-year low of 18.7%, June's portfolio investment was up from a year ago. And while its current account deficit is a high 4% of GDP, Colombia has ample foreign direct investment and currency reserves. Moreover, Colombia has something that only one other Latin American country has—an investment-grade credit rating.

GROWTH SLOWS, BUT A RECOVERY IS IN SIGHT



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• 1GB high-speed EDO DRAM
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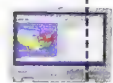
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DON'T WORRY, BE BULLISH

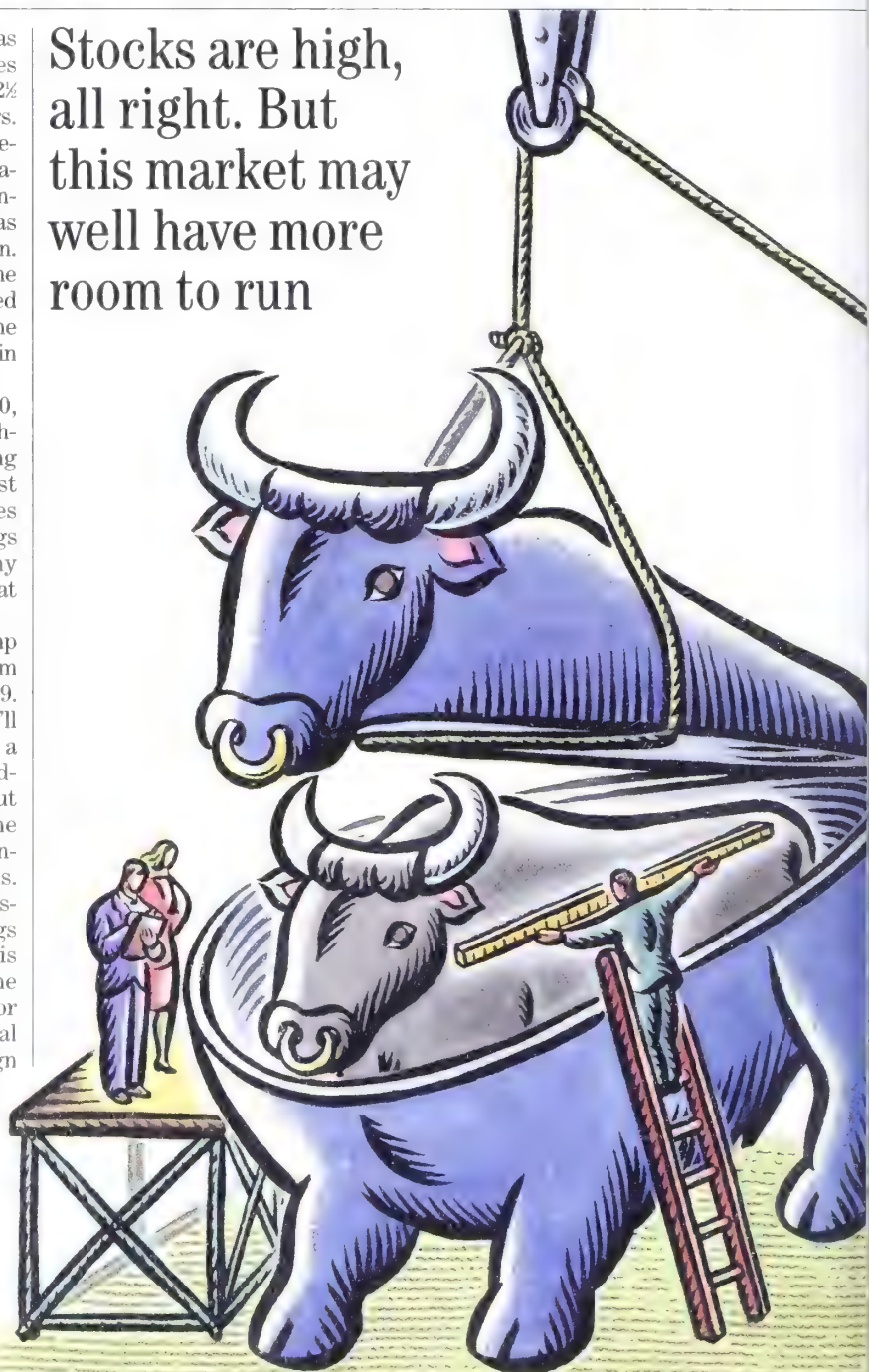
The rip-roaring bull market that has more than doubled the Dow Jones industrial average over the past 2½ years has always had its doubters. Bears have long warned of a sharp decline because stock prices—when measured by standard yardsticks of earnings, dividends, or book value—were as high or higher than they had ever been. No matter. The bull charged ahead. The bears who bailed out a year ago missed some juicy profits: a 51% jump in the Dow Jones industrials and a 49% rise in the Standard & Poor's 500 index.

Now, with the Dow nearing 8100, even bullish investors are taking another look at valuation. They're rerunning their models, incorporating the latest info on stock prices (up), interest rates (down), inflation (benign), and earnings growth (better than expected). Many are concluding stocks are overvalued—at least a bit.

BLISSFUL CONDITIONS. But don't dump your stocks just yet. Forget the grim comparisons to 1987 and or even 1929. Look forward, not backward, and you'll see that an S&P 500 that's selling at a historically heady 23 times the preceding 12 months' earnings maybe isn't out of line. The remarkable state of the U.S. economy is providing all the ingredients for more stock market gains. Growth remains strong, incomes are rising, productivity is improving, earnings are expanding, the budget deficit is shrinking, and inflation is tepid. The technical landscape is also superb for equities: strong demand from mutual funds, corporate investors, and foreign buyers. These blissful conditions may not last forever, but they're the only thing on the radar screen now.

Given these conditions, even many analysts whose models indicate overvaluation aren't alarmed. "We're a long way from the levels of 1987," says Robert E. Butman, a consultant to DAIS Group, a research boutique that caters to institutional investors. By his reckoning, stocks are about

Stocks are high,
all right. But
this market may
well have more
room to run



FINDING CHEAP STOCKS IN A PRICED MARKET

One approach uses future earnings and interest rates to gauge value. Using such a model, the DAIS Group compiled this list of undervalued stocks.

	RECENT PRICE	EXPECTED ONE YEAR GAIN
CORPORATE EXPRESS	14	171%
CORRECTIONS CORP. OF AMERICA	42	150
PETSMART	11	145
ASCEND COMM.	52	142
BOSTON CHICKEN	13	132
REPUBLIC INDUSTRIES	23	127
U.S. CELLULAR	30	127
ASPECT TELECOM	19	120
LEARNING COMPANY	10	98
COOPER CAMERON	50	89
WORLD COM	32	83
HFS	58	82
ACCUSTAFF	27	81

Another method uses private market value (PMV), based on cash flow and balance sheet data. The lower the price is to PMV, the bigger the bargain.

	RECENT PRICE	PRIVATE MARKET VALUE
LOEWS	103	0.18
USF&G	25	0.26
CHRYSLER	36	0.31
AETNA	107	0.32
RJR NABISCO HOLDINGS	31	0.43
JOHNSON CONTROLS	43	0.47
DELTA AIR LINES	88	0.48
GENERAL MOTORS	58	0.48
AMR	99	0.49
BRIGGS & STRATTON	50	0.52
WHIRLPOOL	49	0.52
GTE	48	0.53
TOSCO	30	0.54

DATA: THE DAIS GROUP, BW

on tools such as dividend discount models (DDM) to help determine whether a stock or the market is cheap or dear. DDM works on the principle that an investment is worth the present value of all the future cash it generates. That means forecasting earnings, estimating the percentage of earnings to be paid in dividends, and using a current interest rate to discount all cash back to today's value. If that's more than the stock's current price, it's a buy; if below the price, it's a sell.

That's not the end of it. DAIS Group, for one, takes this further and calculates an expected return for a stock a year from now. Among the most promising:

Corporate Express, an office-supply retailer, Corrections Corp. of America, a prison operator, and Ascend Communications, a network equipment maker. The same method spots overvalued stocks. Among DAIS's sell candidates: Champion International, Host Marriott, and blue-chip favorites Procter & Gamble, General Electric, and Coca-Cola.

Most pros use multiple methods to value a stock. Another measure, private market value (PMV), gauges a company's worth by its cash flow and assets. Leveraged-buyout specialists use PMV to find takeover candidates. DAIS uses the technique to find undervalued stocks. It compares a company's stock price to its PMV. The lower the ratio, the more undervalued the stock. Using this screen, the research house added insurers USF&G and Aetna and auto makers Chrysler and General Motors to its list of most attractive stocks.

For investors who have seen their index funds and 401(k) accounts soar, it may look like time to cash out. And there's nothing wrong with taking profits.

But the cries of overvaluation have been heard before—as the market moved higher. As long as the economy continues to grow and inflation stays low, the naysayers will be wrong.

By Jeffrey M. Laderman in New York

overvalued, vs. 16% Oct. 1, 1987—just a few weeks before the one-day plunge in market history. Peter Canelo, an investment strategist for Morgan Stanley, Dean Witter, Discover & Co., rates the market to about 12% overvalued. But that comes looking at the S&P not at the mid-cap small-cap stocks still offer more attractive valuations. The strongest buy lately came from Federal Reserve Chair Alan Greenspan. In July 22 testimony before Congress, he said the economy's performance "exceptional." Greenspan let it be known that he would raise rates if necessary, but left investors with the impression that no hike was imminent.

Dow logged 155 points to close at 8062 and added 27 points on July 23.

Greenspan never mentioned the "new economy," but, increasingly, investors are sensing that the

economy is changing in fundamental ways. "We're in the seventh year of an economic expansion and inflation is rising and falling," says John F. Snyder, portfolio manager of the John Hancock Sovereign Investors Fund. "Things are different. The higher valuations can be justified."

Take the stock of Gillette Co. Brenda Landry, a veteran analyst at Morgan Stanley, Dean Witter, says she has convinced clients that at \$101 a share—3 times expected 1998 earnings—it is a buy. But like many venerable manufacturers, once-sleepy Gillette has slumped and is now a world-class competitor. Earnings have been growing at 18% a year, and Landry predicts growth of 17% a year for the next five years. "Toss in a 1% dividend, and you earn 18% a year from steady, reliable Gillette, vs. 6.4% in a bond," says Landry. "Which would you choose?"

If interest rates continue to ease, it's a no-brainer. In a falling rate climate, stocks can pay off even better than

bonds. DAIS's forecast, for instance, is based on a long-term interest rate of 6.4%. But if the long bond were to drop to 5.9%, the market would be slightly undervalued, says DAIS's Butman. In the first three weeks of July, long-term interest rates came down about 0.4 percentage points to around 6.4%. And earnings estimates for 1998 are working their way higher.

FORWARD-LOOKING YARDSTICKS. What's the best way to value stocks now? Some long-used yardsticks, like comparing price to historic book value or dividend yields, are not so reliable in today's market. For instance, massive restructurings and write-offs in the early 1990s rendered book value—a company's assets less liabilities—a relatively useless measure. By the same token,

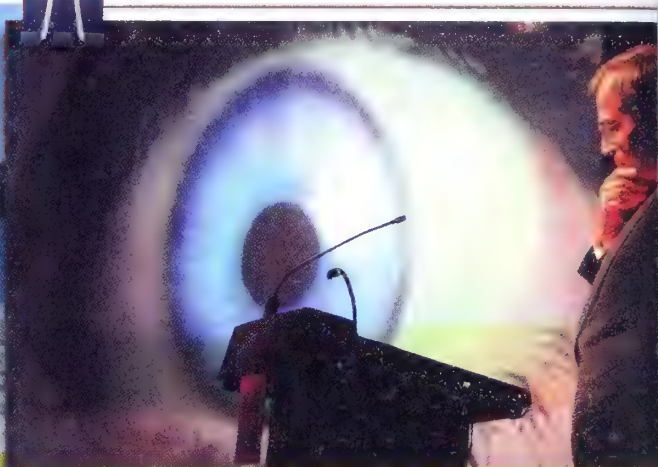
companies have channeled cash they once spent on dividends into share repurchases that boost stock prices. So even though dividend yields are low, valuations aren't necessarily out of line.

Many yardsticks are limited because they don't incorporate future expectations—and it's expectations that are driving investors. That's why many pros are focusing





NO SNAP The film business is shrinking—and Kodak is losing share in both the consumer and professional markets



FURIOUS GEORGE CEO Fisher is fuming over Fuji's tactics but says his company's setbacks are temporary

STRATEGIES

A DARK KODAK MOMENT

A surprise Fuji attack has helped stall the company's turnaround and buffeted its stock

George M.C. Fisher is furious. Earlier this year, longtime nemesis Fuji caught the Eastman Kodak Co. chief executive off guard with a surprise attack on the U.S. color film business. Fuji cut prices by as much as 50% on multiple-roll packs, in some cases selling four rolls of film for \$4.99 at Kmart stores. "Their marketing is crazy" fumes the 56-year-old Fisher. "If they want to put their brand in the mud, let them fight it out with the low-end guys," he adds.

Crazy or not, Fuji's move has helped stall the turnaround that Fisher launched when he arrived at Kodak in December, 1993. On July 16, Kodak reported an abysmal 16% drop in second-quarter profits on an anemic 2% gain in sales from continuing operations. That was well below Wall Street's expectations, and Fisher previewed more trouble ahead: a likely fall in full-year operating profits below last year's \$3.1 billion. Kodak's stock dropped to \$68 a share, a 52-week low. Fisher's own options lost \$100 million in value within hours of the earnings announcement.

The Kodak CEO is "in the trenches, and he's having trouble executing," says Merrill Lynch analyst Robert P. Curran, who pulled his buy rating on Kodak after the news.

It's not the kind of Kodak moment Fisher expected. The highly regarded former Motorola Inc. chairman spent two years restructuring, cutting 14,700 jobs, and selling off \$8.9 billion in non-core assets such as Eastman Chemical Co. and the copier business. His plan to revive 118-year-old Kodak pushed the company's share price to an all-time high of \$94 in February, nearly double where it stood when Fisher took over.

SEEING RED. What went wrong? For starters, Kodak's push into digital photography is taking longer and costing more than expected. Digital imaging, Fisher's most ambitious effort, has rung up \$100 million in red ink this year. Also, the Advanced Photo System that records digital data about each exposure got off to a poor start last year. Kodak budgeted a \$100 million marketing campaign for APS this year, but losses have been higher than planned.

Meanwhile, a stronger dollar has cut into expected gains overseas.

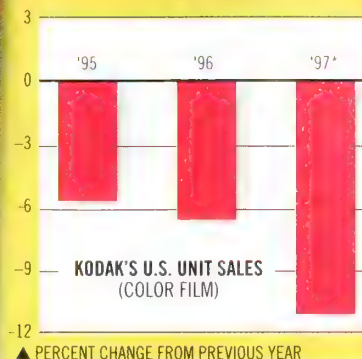
Then there's Fuji. Kodak has repeatedly accused the Japanese photo giant of unfair trade practices in the U.S. and Japan. But while a formal trade dispute remains unresolved, Fuji has been grabbing business from Kodak in both color film and photographic paper. After losing a dumping case in 1994 in which Kodak convinced the U.S. government that Fuji was selling photo paper in the U.S. at one-fourth the price it was charging in Japan, Fuji invested more than \$1 billion in new manufacturing facilities in Greenwood, S.C. Last year, Fuji opened a paper plant at the site and has since grabbed back the 20% share of the U.S. photofinishing business it had before losing the dumping case. A color film plant at the South Carolina site will start production later this year.

In the meantime, despite a 3.7% tariff on all imported film, Fuji has turned up the heat. Price-cutting resulted in a 28% increase in shipments of Fuji color film through June 22 of this year, while Kodak's dropped 11%, according to



LAM? Kodak's U.S. woes are worsened by anglehold on Japan's film market

DECLINING FILM SALES...

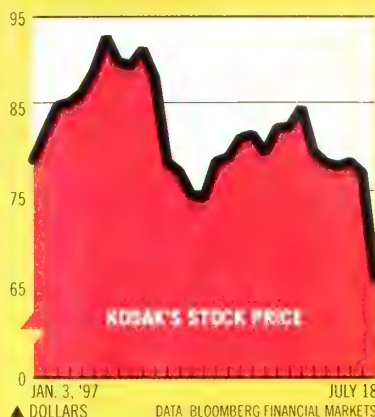


▲ PERCENT CHANGE FROM PREVIOUS YEAR

TOTAL U.S. FILM MARKET (UNITS)
291 MILLION 274 MILLION 111 MILLION

DATA: INFORMATION RESOURCES INC. *THROUGH JUNE 22

...AND FALLING STOCK MARKET VALUATION



ation Resources Inc. Making matters worse, the market is contracting, in part because consumers buy huge quantities of disposable cameras, says IRI. Fuji is not just winning over cost-conscious consumers. "Fuji is steadily eroding Kodak's lead in the professional photography market," says Ray Pryor, president for operations at Chicago Gamma Labs, a large photofinisher. The reason: Fuji has been generous with free samples, Pryor says.

A ROLL. Analysts expect Fuji to continue gaining ground. "The momentum is in Fuji's court," says Prudential Securities Inc.'s Alex Henderson. He expects Fuji's gains in the U.S. to push it to Kodak in worldwide market share by 1998 or 1999. Kodak's 1996 share was 40%, vs. 35% for Fuji, but the gap has now narrowed to 39% vs. 40%, Henderson says.

Fuji's U.S. consumer-market vice-president, Paul A. Henderson, denies he's waging a price war against Kodak. While he admits that Fuji charged unusually low prices in this year's first half, he says such pricing schemes disappeared in the second half. Fisher claims Fuji can afford to slash prices because it has a protected sanctuary in Japan, where it has a 70% market share and, Henderson asserts, controls film distribution pricing. Kodak's charges to that effect, filed in May, 1995, are under review by the World Trade Organization.

But even a favorable outcome for Kodak won't alter the competitive landscape in the U.S. anytime soon. That's what Fisher says that Kodak will continue

responding to Fuji with aggressive promotions of its own. Still, he acknowledges that Kodak may continue to lose market share to its Japanese rival.

Ultimately, Fisher needs to counter those losses with new sources of revenue. The source he thought most promising—digital imaging—is behind

Kodak must offset slowing film sales with new revenue sources. But it's counting on digital photography—and most of the products are still in the lab



schedule. Fisher had predicted that Kodak's digital business would be profitable this year, but instead the losses are widening. One reason, says Fisher: "The scope of our digital effort has expanded dramatically" since he took over. Many of Kodak's digital products are still in the lab, though a key one—an

Internet-based digital photo service—is set to debut later this year.

Fisher maintains that the second-quarter debacle reflects only short-term glitches, not a problem with his strategy. "When you're trying to do as many things as we're doing, there's bound to be some things that don't improve as fast as you planned," says Fisher. He adds: "I don't have the slightest hesitation that we're on the right track."

He has believers, too. "He's a tough guy to bet against," says Erick Lucera, who follows Kodak for Independence Investment Advisors in Boston, which manages \$26 billion in pension-fund assets. "He's investing for the long term, and that's what he needs to do."

Other analysts believe Kodak will continue to lose share to Fuji. And Prudential's Henderson predicts that competition will be so stiff in digital imaging that Kodak may never see a big payoff from its investments.

Fisher has no patience for the skeptics. "People that get weak-kneed because they can't earn what the Street expects them to earn don't have a future," says Fisher. And though he has been mentioned as a leading candidate to become chairman of troubled AT&T, he vows to stay at Kodak until at least 2000. "There's no way I could ethically or morally leave this situation," he says. Those words might assure Kodak employees. But investors are now looking for tangible results from a strategy that, for now, has drifted out of focus.

By Geoffrey Smith in Boston, with Brad Wolverton in Atlanta, Ann Therese Palmer in Chicago, and bureau reports

DEALMAKERS

PROFESSOR MILKEN'S LESSON PLAN

He sees billions in education, tech consulting, and training

The audience has changed from bond traders to public school superintendents. But Michael R. Milken, the convicted junk-bond king who once held court at the Predators' Ball, still knows how to work a crowd. At the Century Plaza Hotel in Los Angeles recently, Milken hosted his annual National Education Conference, where he handed out \$25,000 awards to outstanding principals and teachers. Milken moderated panels on technology in the classroom and the economics of educational software and programming.

Milken is putting a lot of time and money into improving public education. But his efforts aren't entirely philanthropic. For Milken, the few million dollars it cost to stage the annual conference is mere pocket change. He has invested far more in a plan to make a fortune in what he calls the biggest opportunity around: the human capital market, by his reckoning a \$100 billion industry, providing goods and services ranging from CD-ROMs for kids to high-tech consulting to employee training for the information economy.

Milken's vehicle: Knowledge Universe, a secretive company he launched last spring with Oracle Chairman Lawrence J. Ellison. Knowledge Universe has quietly built up a collection of businesses that, according to company president Thomas Kalinske, already totals \$600 million in sales and will reach \$1 billion in revenue by the end of the year. **TECHIE DROUGHT.** Those sales will come from a collection of companies that Milken has snapped up or invested in. They include a 50.1% stake in CRT, a British consulting and training company bought for \$169 million, and most of the franchisees of Productivity Point International Inc., a Plantation (Fla.)-based training company. On July 23, he acquired Symmetrix, an \$18 million technology-consulting outfit near Boston. Up to seven more acquisitions are in the pipeline, say company executives.

The plan is for Knowledge Universe to be the leading brand name in the fast-growing business of education products and services. "We are suffering a chronic shortage of high-tech professionals right now. You would have to

be an idiot to lose money in the knowledge market over the next few years," says Stan Lepeak of META Group Inc., a technology consulting firm.

Milken, who's still worth an estimated \$500 million, backed Knowledge Universe with \$125 million of his own money.



INFO HONCHO: Milken has been on a shopping spree

His brother, Lowell, matched that contribution, and Ellison pitched in \$250 million. To run the empire's divisions, Milken has enlisted veterans from the consulting, training, and toy industries. Paul Garcia, a former First Data Corp. executive, heads training. Kalinske, former CEO of Sega of America and Mattel Inc., is president of the holding company and CEO of the nascent kids' division. Gresham T. Brebach, formerly an executive vice-president at Renaissance Solutions and a director of McKinsey & Co., came on board in February as chief executive of the consulting division.

The most aggressive push at the moment is in the information-technology (IT) consulting arm. The company in-

tends to create a comprehensive line of services—from consulting on production and process technologies to device methods for valuing employees. Such consulting services are a hot growth area—40% to 50% a year, analysts say. But it's hardly uncharted territory, with all the major accounting giants, such as Andersen Consulting, well entrenched as well as specialists occupying every niche. Says James Sims, chief executive of Cambridge Technology Partners: "It sounds like they aim to attack all six major areas of IT consulting at once. I would question that."

Milken's ambitions in the kids' education market might be even tougher.

EXPANDING GALAXY

The former junk-bond king Knowledge Universe is growing fast

CONSULTING Annual revenues: \$20 million. Acquire Symmetrix consultancy, with \$18 million in sales, July 23. Four more acquisitions planned for this year.

TRAINING Annual revenues: \$500 million. Paid \$169 million last year for 50.1% of British trainer CRT. Bought most of Productivity Point International, with \$150 million in sales. Now acquiring the rest of the company.

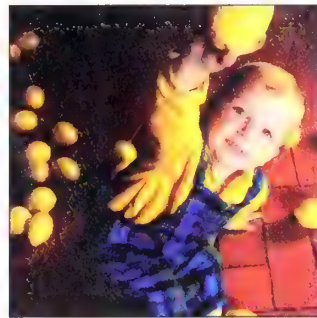
KIDS EDUCATIONAL PRODUCTS Three acquisitions in progress. Emphasis on software, Internet publishing, and books.

DATA BUSINESS WEEK

realize. Shortly after joining forces with Milken, Kalinske made an unsuccessful offer for Knowledge Adventure, a leader in "edutainment" computer programs. He's now stalking three other possible acquisitions. But the consolidating market has few worthy targets left.

Milken has even grander long-term plans, including a "virtual university" that would be beamed to students via satellite television or over the Internet. But despite the outsize ambitions, Knowledge Universe has one factor that can't be discounted: Milken himself. "He's our greatest off-balance-sheet asset," says Brebach. Will the junk-bond genius of the '80s become the human capital titan of the 21st century?

By Kathleen Morris in Los Angeles and Lisa Sanders in New York



*Lumina owners have at least one reason
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L u m i n a L S Here are some more: standard dual air bags,

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COMMENTARY

By Howard Gleckman

MY DAD'S HARROWING TRIP THROUGH A MEDICARE HMO

A little more than a year ago, I learned that my father was dying. "Let me put it to you this way: I wouldn't sell him a six-month life-insurance policy," said the cardiologist, who knew everything—and nothing—about the human heart.

Since that day in May, 1996, my mother and I watched heart disease drain my father's life away. First, he could not walk unaided. Then, he could not eat or sit up or speak. Even music, which he had loved since childhood, was lost to him. On July 8, 1997, my father died.

In those 14 months, I saw close up how medical care is delivered to chronically ill seniors by health-maintenance organizations trying to balance cost-saving with care. It was discouraging.

If my family's experience was any gauge, there is a yawning gulf between the promise of Medicare HMOs and reality. They pledge seniors low-cost, comprehensive care. But the HMOs are businesses

that can view the frail elderly—who need costly treatment—as a drain on earnings. To assure good care for my father, we had to spend a tremendous amount of time and energy negotiating with doctors and plan representatives. But my father was lucky. He had my mother and me. What of the elderly who are alone?

FEW OPTIONS. More than 100,000 seniors are joining HMOs every month, and they now make up 12% of the Medicare population. This explosive growth is no surprise: HMOs promise all the benefits of Medicare and often offer extras, such as free prescription drugs. For many seniors, the only alternative is Medigap, private insurance that supplements Medicare. Such policies can be expensive. My mother pays \$133 a month for hers.

President Clinton and many congressional Republicans see HMOs as the key to driving down skyrocket-

ing Medicare costs. The coming budget deal will likely push more seniors into the plans.

Yet despite the rush to HMOs, no one really knows if they provide quality care for the frail elderly. One study, by John E. Ware of the New England Medical Center, found that chronically ill patients in HMOs were twice as likely to suffer physical decline as those in traditional Medicare. Says Bruce M. Fried, director of Medicare's Office of Managed Care: "I think we don't know enough."



MARILYN AND THE LATE HERBERT GLECKMAN: *What price care?*

My father's plan, Prudential HealthCare SeniorCare, did fine while he was relatively healthy and even immediately following his first heart attack. But that changed with the second episode of heart failure. On Aug. 21, after he had been in the hospital for nine days, my mother received a frightening phone call: After that day, Prudential would no longer pay for his stay. Unable to walk, catheterized, and loaded with medication, my father went home as my mother scrambled to find the 24-hour care he needed.

Once he was home, getting care became a bureaucratic nightmare. He could not see a specialist without first visiting his primary-care doctor. That meant two office visits, each by ambulance. We also found that his doctor was painfully slow in responding to problems. When we complained, Prudential's advice was to change doctors. My mother called

three. One wouldn't take any more HMO patients. The other two never even called back.

In a written statement, Amy Knapp, executive director of Prudential HealthCare-South Florida said: "Our records indicate Mr. Gleckman's physicians worked very closely with him to assure he was receiving the care he needed... Prudential HealthCare realizes... there may be circumstances where a member's expectations are not met."

BARE MINIMUM. My father had the right to quit the HMO and return to Medicare. But given his condition he would never have been able to buy Medigap insurance. As his illness worsened, my father asked that no heroic measures be taken to prolong his life. He became a patient at a hospice that sent a nurse to visit him at home twice a week. In a system where Medicare spends more than \$63 billion annually to care for the elderly in the last year of life, my father chose to

avoid costly hospitals. Still, getting even the modest care he needed to stay comfortable was a struggle.

Some HMOs are trying to do better. A few are giving patients long-term referrals to specialists rather than requiring a primary-care visit every time. Others have developed hospice-like team approach in which nurses, social workers, doctors, and even clergy work together.

Still, questions about quality of care have largely been lost in the debate over the financially troubled Medicare system. Congress is so fixated on finding \$115 billion in budget savings that it has become oblivious to the consequences. There may be way to hold down costs and provide high-quality care. But when it comes to the frail elderly, we are far from finding it.

Gleckman covers economic trends from Washington.

READY

lions of businesses and consumers are looking for a secure way to buy and sell merchandise over the Internet.

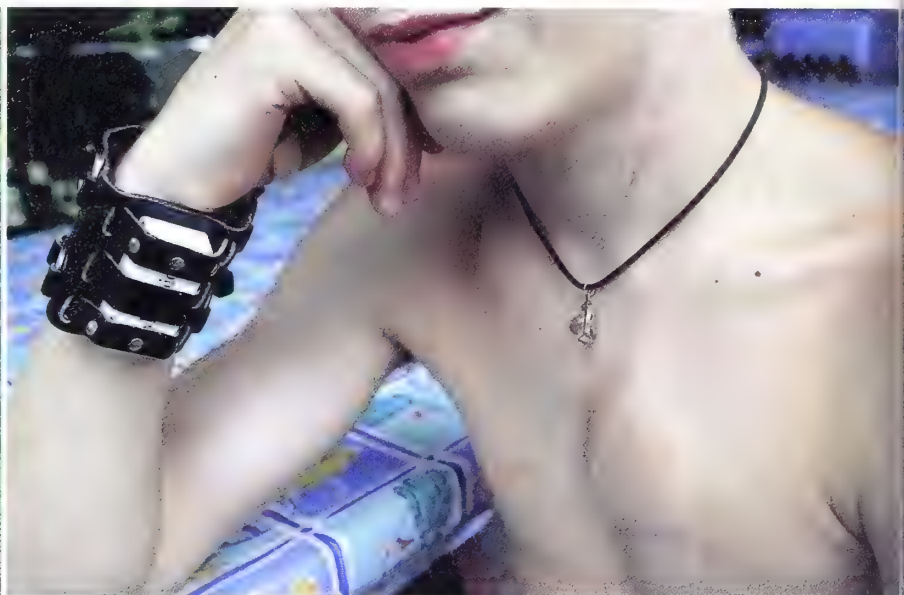
MEDICINE

EPILEPSY: THE ADVANCE OF THE CENTURY

Cyberonics' antiseizure device could revolutionize treatment

For years, Albert Jean fought a losing battle against epilepsy. Because of frequent uncontrollable seizures, the Reading (Mass.) youngster couldn't ride a bike, swim, or cross the street. In junior high school, a teacher had to walk him to and from classes. "I didn't want to be walked like a baby, even though I knew it was for my own safety," says Jean, now 15. "I felt like an idiot."

cure for epilepsy, it significantly reduces the number and severity of seizures. That can make a difference in the activity, self-confidence, and overall well-being of those who suffer from the neurological disorder. Indeed, the product so impressed the FDA that it expedited Cyberonics' review process and approved the device several months earlier than expected.



UNDER MY SKIN: Jean lives normally thanks to the electrode in his chest, which he can activate with a special wristband

But when he starts high school this fall, Jean plans to go solo. That's because his seizures have substantially subsided thanks to the first new therapy for epilepsy since drugs were tried 100 years ago. Implanted in Jean's chest is a pacemaker-like electrode that continuously sends seizure-blocking signals to the brain through a nerve in his neck—and that he can activate if he feels a seizure coming on. Jean got the setup last year as part of a clinical trial by its manufacturer, Cyberonics Inc., based in Webster, Tex., near Houston. Says Jean: "I feel like an absolute different person."

Cyberonics, which on July 16 received Food & Drug Administration approval to market the product in the U.S., is about to feel like an absolutely different company. While the vagus nerve stimulator—as the device is called—is not a

The phone has been ringing off the hook at Cyberonics ever since. Analysts, investors, and medical experts say the 10-year-old company—which has lost some \$60 million since going public at 12 a share in 1993—now seems poised to take off. Its shares have jumped nearly 17%, to 8%, since the FDA nod.

LUCRATIVE MARKET. Analysts now expect the company to turn a profit within the next two to three years. "This is the only product like this in the world," says analyst John R. Boettiger Sr. of Houston-based investment banking firm Harris Webb & Garrison. "Cyberonics has an unquestionable monopoly."

The market looks lucrative, too. Of the nearly 2 million Americans with epilepsy, doctors estimate that 200,000 cannot be treated adequately with drugs. At \$9,000 for each Cyberonics device,

that's a potential U.S. market of \$1.8 billion. Those who use anti-epilepsy drugs might be tempted to switch because the side effects of using the cyberonics device—coughing, hoarseness, and shortness of breath that can occur during stimulation—are less severe.

Cyberonics is the brainchild of J. Zabara, a now retired Temple University neurophysiologist. Using medical research dating to the 1930s, he hypothesized that stimulation of the brain via the vagus nerve could create an anticonvulsion effect. Zabara joined with Reese S. Terry, now Cyberonics chairman, to obtain seed money from venture capitalists including Robert Cummins, now Cyberonics' chief executive. St. Jude Medical Inc., a cardiovascular-device maker based

St. Paul, Minn., holds a 16% stake.

Now the company has to prove it can manufacture and sell its invention. Half of the company's 16-person direct-sales force has been hired since May. To meet 3,000 stimulators next year and as many as 7,000 in 1999, Cyberonics also is seeking support from physicians who participated in some seven clinical studies over the years. The company has about \$15 million in cash but needs as much as \$30 million to ramp up manufacturing and marketing. An easy solution might be to sell out to a big medical-equipment maker. But for now, Cummins says he's not even thinking about that. "We're focused on making [the device] a success," he says. For Albert Jean, it's ready is.

*By Stephanie Anderson For
in Dallas*

SET

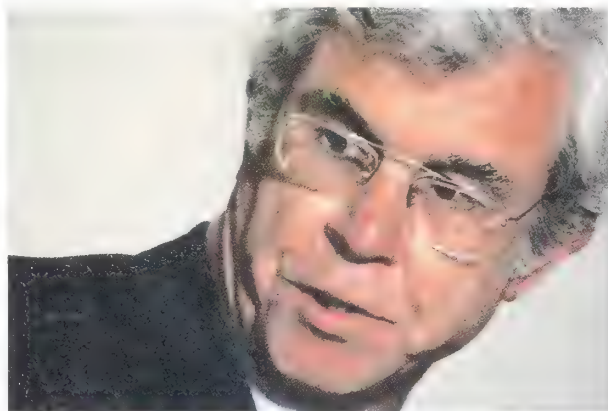
MasterCard and Visa, in partnership with IBM and other companies, created SET (stands for Secure Electronic Transaction), an open industry standard allowing secure credit card transactions over the Internet.

BANKING

A BANK AT NEARLY ANY PRICE

Even at big multiples of book value, deals keep getting done

Eight weeks ago, Signet Bank Chairman Malcolm S. McDonald announced plans to shut or sell a fifth of his bank's branches, cut its 4,400-person workforce by a quarter, and slash expenses by \$58 million. That doesn't seem like performance that would justify one of the priciest bank buyouts in history. But on July 21, First Union Corp. announced it would pay \$3.25 billion for Signet, based in Richmond, Va., a breathtaking 3.5 times book value. First Union Chairman and CEO Edward E. Crutchfield was so keyed up about the deal that, unable to sleep, he left his New York City hotel at 4:30 on the morning of the announcement to go



FIRST UNION Crutchfield is still pleased with the Signet deal, but he admits to feeling some sticker shock.

out in search of an all-night newsstand.

The price of banking deals these days is enough to give anybody insomnia. Two years ago, few bankers would have dreamed of paying so dearly for a bank in Signet's shape. But for Crutchfield and other CEOs of major banks, who believe financial services will be dominated by a dozen or so major players, the options are simple: merge or molder.

So the prices keep rising. Nations-Bank Corp. paid 2.6 times book value

for St. Louis-based Boatmen's Bancshares Inc. in a \$9.5 billion deal last October. Then First Bank System bought U.S. Bancorp in March at 3.4 times book, and Wachovia paid 2.8 times book value in June for Central Fidelity. "The trend is clearly up as we get fewer and fewer trophy franchises available," says R. Harold Schroeder, analyst with Keefe, Bruyette & Woods Inc. The top trophies still out there, say analysts and industry sources, include Summit Bancorp in New Jersey, Mercantile Bancorporation in St. Louis, and Firststar Corp. in Milwaukee.

The hot stock market is fueling the price spiral—raising the tags of targets and giving buyers inflated shares to use as currency. Shares of both First Union and Signet are up more than 50% since last July. And with First Union's stock dropping only 3% the day the Signet deal was announced, investors seem to be comfortable with the price tags.

Still, Crutchfield himself admits to sticker shock. In his 13 years at the helm, he has notched nearly 80 deals while building First Union, based in Charlotte, N.C., into the nation's sixth largest bank. "It would not have occurred to me 10 years ago that I'd ever pay 1.5 times book, much less what I'm paying for Signet," Crutchfield says.

"YARDMEN"? But he thinks he can make the Signet deal work. He may close as many as 100 branches, yet still be the top bank in the state. And First Union's strong back-office operation as well as its financial-management and brokerage services should improve efficiencies and revenues. "First Union has a great track record of quickly integrating and carving out costs," says

Sandra J. Flannigan, a banking analyst at Merrill Lynch & Co.

Crutchfield says he expects to feel right at home in the wealthy Virginia market. "People who live in North Carolina used to be yardmen for the people in Virginia, so we feel very close," he jokes. Still, at the prices Crutchfield and others are paying, there will be lots of tilling and uprooting before many of the current deals pay off.

By David Greising in Atlanta



UNIONS

'DISASTER' FOR MOTOWN PAPERS

Having to rehire strikers would be a major defeat

It looked like a clear victory for management in one of the nation's longest-running and most public labor disputes. When some 2,100 strikers walked off the job two years ago, *The Detroit News* and the *Detroit Press*, the papers' joint owners, Gannett Co. and Knight-Ridder Inc., placed strikers with permanent hires and wiped away union work rules. The move was costly: Circulation by a third, and losses topped \$200 million. But the companies prevailed. They didn't miss a single day of publication and are edging back into the black.

Now, their win may be reversed. In mid-June, a federal labor-law judge ruled that the papers had committed a raft of illegal labor practices, such as unilaterally imposing a new pay scale. In early July, the National Labor Relations Board sought an injunction to require the papers to take back the strikers. On July 31, a Federal District Court in Detroit is scheduled to hold hearings on the injunction—and it's likely to rule against Detroit Newspapers Inc., the company Gannett and KR set up to run the two papers. "Our success rate on injunctions has been about 90% in recent years, including appeals," says NLRB Chairman William B. Gould IV.

The papers say they'll come out top at the hearing and vow to appeal if they don't. If they lose, "that would be a disaster," says John Morton, head of



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Morton Research Inc., a Spencerville (Md.) company that tracks the industry. Detroit Newspapers would be forced to either fire replacements or operate at elevated staffing levels, Morton says. Costs would soar either way. Susie Ellwood, Detroit Newspapers' vice-president for marketing, says the papers may have to recall strikers if the injunction is upheld.

Rehiring would undo management's strategy and set back years of efforts to lift the papers' profitability. In 1989, Detroit's two big dailies got Justice Dept. permission to partially merge operations. But readership continued to slide, so Gannett and KR demanded changes in union work rules to cut costs, prompting a walkout on July 13, 1995. Gannett and KR adopted a take-no-prisoners stance. The papers hired new staffers and promised not to dump them if the strikers gave up. Management brought in hundreds of guards and even helicopter papers out over the heads of picketing strikers. Motor City expressed solidarity with a boycott that slashed circulation by a third. Detroit Newspapers lost \$150 million in 1996 and \$50 million last year.

SPOILED PLANS. More losses loom if the papers have to recall the strikers, analysts say. In February, the unions declared the strike over and management agreed to rehire strikers. But the company refused to displace the workers it had hired during the strike. Since then, the papers have recalled 200 strikers, says Ellwood. Now the papers might have to bring back 1,091 more, leaving little room for the 1,115 replacements now on the job.

The injunction would ruin the Gannett/KR strategy if it is upheld. The papers had expected to turn a profit this year because new work rules enabled them to publish with some 400 fewer full-time workers. If they are forced to rehire the strikers, management would have twice the staff it needs. So it would almost certainly fire many replacement workers. Even that would be costly. Some replacements would probably sue for damages. Others would probably collect large severance packages. Ellwood declines to estimate the potential cost.

Even if Gannett and KR defeat the injunction, the papers would still face charges of labor-law violations that could again require them to recall strikers—and cough up some \$50 million a year in back pay. That case would take years to be resolved. But it means the strike may well wind up costing the papers a lot more than they bargained for.

By Aaron Bernstein in Washington

COMMENTARY

By Peter Coy

HELP! I'M A PRISONER IN A SHRINKING CUBICLE



BOXED IN: A peek at the future

It's not paranoia. It's not claustrophobia. The walls really are closing in. Offices are being torn down to make way for cubicles, and big cubicles are being chopped into small ones. Facility Performance Group Inc. in Ann Arbor, Mich., says work spaces have shrunk 25% to 50% over 10 years for most workers at 70 big trend-setting companies. Offices now require 5 to 6 parking slots per 1,000 rentable square feet, up from 3.5 to 4 a few years ago, the International Facility Management Assn. says.

This is one unhealthy trend. If it keeps up, by 2097 a typical middle manager's work area will be 8 square feet—just enough for one person of ordinary girth, a plaque with the corporate motto ("People are our most important asset"), and a set of *Dilbert* cartoon books.

The first problem here is the eagerness to save money on real estate at the expense of employees' comfort and dignity. Second is the assumption that open spaces promote teamwork. If that's so, then why are upper managers—who spend entire days in meetings—hardly ever encountered in cubicles?

Disclosure: We at BUSINESS WEEK's New York headquarters recently were informed that most of us will lose our private offices in a year or two. This prompted a closer look at cubicles, which are occupied by some 35 million of the 45 million white-col-

lar workers in this country.

Cubicles do have advantages. They're cheap to install and rearrange. They make it easier for managers to monitor employees—always a popular pastime. And they increase communication, because people overhear one another.

In fact, they overhear one another hour after hour. For many workers, cubicles are too open to permit deep concentration. At the same time, they're too closed for spontaneous collaboration. Indeed, com-

panies with cubicles are now creating meeting areas to foster teamwork. Good idea—except they're shrinking cubicles to make room for the new communal spaces.

Here's a solution: Take a hard look at whether cutting costs on real estate is driving away good employees and shriveling the brains of those who stay. Then, give cubicles to people who can thrive in them, and private offices to people who need private spaces—based on function, not pay scale. Microsoft Corp., which has development projects requiring intense collaboration, nonetheless gives its programmers private offices. Why? So they can think—and because the perk helps attract top talent. Adobe Systems Inc. likewise went from 40% private offices to 98% when it moved into new headquarters in San Jose, Calif., last August.

Shooing people out of private offices doesn't guarantee a burst of brilliant collaboration. "There's a tendency for people to assume you can buy the right furniture and suddenly get teams out of it," says Jeff Reuschel, manager of officing research for Haworth Inc. in Holland, Mich. Brainstorming among people lacking peace and quiet produces brain drizzle. Companies such as Microsoft and Adobe understand that.

Coy is associate economics editor

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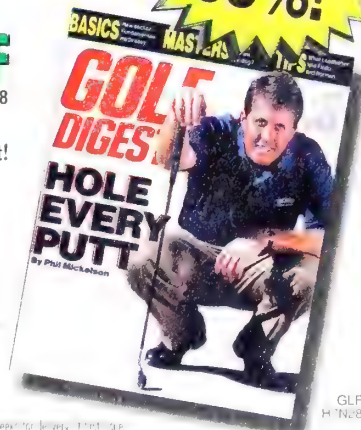
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EDITED BY KELLEY HOLLAND

BOEING-McDONNELL GETS A THUMBS-UP

IT WAS A HIGH-STAKES GAME of poker until the last minute, but Boeing managed to win European Union endorsement on July 23 for its \$14 billion merger with McDonnell Douglas. Boeing left some chips on the table: It agreed to give up the exclusive-supplier agreements it had negotiated with American Airlines, Delta Air Lines, and Continental Airlines. "If we allow this type of long-term exclusive contract, the competitors will be out of business," complained European antitrust chief Karel van Miert, who worried that the combined company would control 85% of the world's air fleet and shut out France's

Airbus Industrie. Now, Boeing is stuck with the generous terms it agreed to when it negotiated the exclusives with the carriers. But Boeing won the big pot: Now there are no obstacles to a final approval of the McDonnell merger, which will be submitted to a shareholder vote on July 25.

PENNZOIL'S SUITOR IS WILLING TO WAIT

THE BATTLE CONTINUES: UNION Pacific Resources is extending until Sept. 24 a \$6.4 billion cash-and-stock tender offer for Pennzoil. As of July 21, Union Pacific Resources had the support of holders of 61.5% of outstanding Pennzoil shares. Pennzoil's anti-takeover defenses mean the tender will have little immediate effect. In fact, Pennzoil CEO James Pate continues to reject as "inadequate" Union Pacific's offer. But analysts say the nearly two-thirds of shares tendered may force Pennzoil management to negotiate. Union Pacific Resources has said it may raise its bid if it can review Pennzoil's books.

WACKENHUT WINS ITS PRISON BID

GO TO JAIL AND COLLECT \$300 million. That's what Wackenhut Corrections will get to do in California. On July 22, the company was awarded the largest privatization contract ever for a prison—a 2,048-bed minimum-security facility in Taft, Calif. Wackenhut beat out competitor Corrections Corp. of America. Managing the Taft prison is expected to generate revenues of as much as \$300 million over the next 10 years. Wackenhut also is competing for other contracts to manage prisons, and not just in the U.S.: One bid is for a 900-bed detention center for Australia's immigration service. That decision is expected in August.

HEADLINER: BERNARD ARNAULT

A SPIRITS RACE PICKS UP SPEED

Bernard Arnault couldn't stay out of the fray much longer. On July 21, the chief of LVMH resigned from Guinness' board in order to pursue his three-way merger proposal for LVMH, Guinness, and GrandMet. His goal: to create a wine-and-spirits giant out of GrandMet's International Distillers & Vintners, LVMH's Moët Hennessy, and Guinness' United Distillers—though Guinness and GrandMet are pursuing a merger of their companies without LVMH.

Resigning from Guinness made it easier for Arnault to sell some of his 14.2%

stake. He is using the proceeds to buy more GrandMet stock, bringing LVMH's GrandMet stake to

11.05%. That gives him enough shares to demand a shareholders' meeting to consider his three-way merger proposal ahead of the meeting planned to consider the Guinness-GrandMet plan.

A Guinness spokesman says: "We are confident our shareholders will vote for our proposal." But if Arnault prevails on GrandMet, life could be difficult for Arnault's former chum at Guinness.

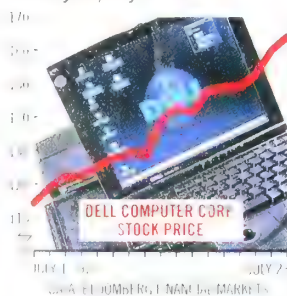
By Mia Trinephi



CLOSING BELL

DELL-LICIOUS

On July 23, Dell Computer's stock hit 167%, a 52-week high and a 211% jump so far this year. Dell, which closed at 164 that day, now sells at a stratospheric p-e: 48 times last year's earnings, about double that of Sun Microsystems, Compaq Computer, and Gateway 2000. One reason: PC success is funding moves into high-margin areas such as engineering workstations, to be announced on July 28. Earnings for the second quarter are expected to rise 85%, to \$196 million, with a jump of 67%, to \$900 million, for the fiscal year, says First Call.



HOW'D YOU GET THIS NUMBER? FROM AOL

WHICH IS MORE ANNOYING: getting a continuous busy signal when trying to go online or rushing to the phone only to find it's a telemarketer calling? Either way, America Online is there for you. The Vienna (Va.) company told its 8 million users on July 21 that it will give their phone numbers to online marketing partners such as CUC International. The marketers are expected to use AOL's phone lists to sell everything from housewares to sporting goods. AOL says its users can have their numbers taken off the lists with a quick click of the mouse.

SUNBEAM SHINES UNDER 'CHAINSAW AL'

AL DUNLAP IS WINNING friends—on Wall Street, at least. A year after "Chain-

saw Al," as Dunlap is known, took the helm at Sunbeam, the troubled appliance maker is recovering. Adjusting its divested operations, Sunbeam's second-quarter income has jumped from \$7.2 million to \$26.2 million. Sales are up 13%. Meanwhile, its stock soared to 40, from 12. "I've done nine major turnarounds and in my view, this was the most difficult," says Dunlap. What's next? Possibly an acquisition or a merger, he says.

ET CETERA...

- Time Warner will acquire News Corp.'s Fox News Channel in New York.
- Clinton formally nominates William Weld to be ambassador to Mexico.
- 3Com and IBM are widening their computer-networking alliance.
- Blue Jays President Paul Beeston will be president of Major League Baseball.

In the World of High-Tech, Change Happens Fast.

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Special report on Silicon
Valley in the August 18,
1997/August 25, 1997
double issue

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CNBC

Complementary coverage of
Silicon Valley for two weeks
beginning August 4, 1997

Check local listings for
channel number and time

This summer Business Week and CNBC are teaming up to provide a comprehensive and timely look at the phenomenon that is Silicon Valley. In its August 18-August 25 special double issue, Business Week will explore the past, present and future of this vaunted slice of Northern California. Beginning August 4 and running throughout the day for two weeks, CNBC will pick up where Business Week leaves off, with complementary coverage in segments throughout the day.

Both Business Week and CNBC will talk to the people who put Silicon Valley on the map and examine how the unorthodox business culture born here has increasingly become the model for Corporate America. Other technology hot-spots around the globe, some already well-known, others likely to become household names, will also be featured in these special reports.

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EDITED BY OWEN ULLMANN

GINGRICH IS ON THIN ICE AND SO IS THE GOP AGENDA

House Republicans love to promote family values, but these days their clan looks more like a bunch of bumbling Borgias than clean-cut Cleavers. The failed coup against Speaker of the House Newt Gingrich that made for delicious political theater—and gleeful Democrats—has an all-too-obvious side for the GOP: It threatens to undermine the Republicans' legislative agenda—and could even jeopardize their under House majority.

Gingrich has put his waning prestige on the line in a bid to persuade House Republicans to adopt a leave-it-to-Newt strategy. Mainstream conservatives and moderates are rallying behind the embattled Speaker so that his deal with President Clinton on a balanced-budget and tax-cut deal don't unravel. Sen. Majority Leader Trent Lott (R-Miss.) is helping by moving toward the conservative House position on taxes.

TO MERGE. Still, the House squabbling far from resolved as Gingrich's allies vow vengeance against coup collaborators. And it could snarl key initiatives such as trade liberalization, new clean-air rules, and approval of the tobacco settlement. "If we don't learn to pull together as a party, our agenda is going to be badly damaged," frets Representative Marge Roukema (R-N.J.).

It's not only the GOP's legislative program that's at risk. Fractured ideological bloodshed could convince voters that Republicans lack the right stuff to rule. "The longer it drags on, the worse the Republican chances in '98," says political analyst Steven E. Schier of Carleton College in Minnesota. Gingrich tried to get his colleagues to set aside their personal animus—at least for the time being—after venting his frustrations at a closed-door meeting set for July 23. "I will not allow another chapter to be written in this tiresome overwrought saga," the Speaker declared. But behind the veneer of unity is a grim reality: shattered trust between Gin-

grich and his closest deputies, Majority Leader Richard K. Armey, Majority Whip Tom DeLay, and House GOP and Conference Chair John A. Boehner, all implicated in the aborted coup. "It's not clear that this group can work together," worries a business lobbyist.

NEW CADRE. An early test will come in September, when the President seeks renewed authority to negotiate trade pacts on a "fast track"—without congressional micromanagement. He will need free-trader Gingrich to rally Republicans behind this top priority of U.S. multinationals. Trouble is, GOP opposition to trade pacts is growing, especially among populist renegades, who are most unhappy with Newt.



WARMER DAYS: Newt Gingrich, Tom DeLay, and Dick Armey in '94

A House divided would also make it harder for Gingrich to craft a compromise between GOP moderates and anti-regulatory conservatives on tougher clean-air rules sought by Clinton. Another casualty could be the tobacco settlement, already facing skeptical Republicans. Moreover, Gingrich will have to struggle to round up the GOP votes needed to approve NATO expansion, a plan facing bipartisan resistance.

Making matters trickier, Gingrich is cobbling together an ad hoc leadership cadre he trusts. It includes Conference Vice-Chair Jennifer B. Dunn of Washington, Chief Deputy Whip J. Dennis Hastert of Illinois, and loyal committee chairmen such as Appropriations czar Bob Livingston of Louisiana.

Gingrich is counting on this popular group to damp the flames of rebellion. But ultimately, it's up to the patriarch to keep his family together. That, Republicans say, means no more ethics flaps, freelance policy pronouncements, or shoot-from-the-lip controversies. Such a fundamental change in style is so unlikely that even admirers wonder how long the Speaker will be sitting at the head of the House GOP table.

By Amy Borrus and Richard S. Dunham

CAPITAL WRAPUP

WANT A NICE WORKER DAY?

In-your-face lobbyist Thomas J. Donohue plans fireworks for Labor Day, when he starts his new job as head of the U.S. Chamber of Commerce. He intends to declare the most sacred day for organized labor as a national "Let's Celebrate Workers" holiday. He'll travel the country in a leased jet, talking up the need for a better-educated workforce, funds for worker retraining, and policies that bring in more skilled immigrants. His intention: steal Big Labor's thunder.

SHUN IRAN—OR ELSE

► The economic noose around Iran may get tighter. A 1996 law imposed sanctions on foreign companies that invest \$40 million or more in Iran's oil sector. On Aug. 5, the law will let President Clinton lower the threshold to \$20 million. Most likely to get burned: France's Total, which is involved in a big Iranian oil project. Clintonites are irked at lackluster support from the European Union, which meets on July 26 to discuss its response to the Iran crackdown.

WIRELESS... AND PENNILESS

► The Federal Communications Commission is scrambling to prevent the default of up to \$9 billion pledged by fledgling wireless telecommunications operators in government-sponsored spectrum auctions last year. On July 22, the agency set up a task force headed by staffer Jon Garcia to recommend solutions to commissioners this fall. One option: restructure the bidders' financing arrangements by stretching out quarterly payments to annual ones.

SOUTH KOREA

QUAKING IN SEOUL

Now, the banks are in trouble, too

One by one, South Korea's huge conglomerates keep keeling over. Since January, the Hanbo and Sammi construction and steel *chaebol*, as these diversified giants are called, have failed under the weight of massive debts. Spirits vendor Jinro and textile giant Dainong are on life support, kept out of bankruptcy only by their creditors. On July 15, the \$20 billion Kia Group, which owns Korea's second-biggest auto maker, barely avoided collapse when lenders dismantled it in exchange for a moratorium on debt payments. Kia Chairman Kim Sun Hong was outraged, says one Seoul bank executive. But the group owes \$10.7 billion. "We had to do something drastic," the banker says.

Now, Seoul officials are confronting a new dimension of the corporate crisis: the possibility of a meltdown in the banking sector. Korean banks were holding at least \$18 billion in dud loans in December. That number is far higher now, and each *chaebol* failure pushes the major commercial banks closer to the brink. This year alone, lenders have given \$24.6 billion—roughly 10% of South Korea's money supply—to the five *chaebol* that have slipped into insolvency. And Standard & Poor's has now placed five banks on a credit watch. If the massive loans prove uncollectible, the banks' combined shareholder equity could be wiped out. The crisis cries out for a dramatic restructuring of the corporate and banking sectors. But the situation is so bad, and resistance to change still so strong, that reforms now proposed may not be enough.

HIGH RISKS. Little wonder that the mood in Seoul is "fraught with tension and uncertainty," says Han Seung Soo, a former Finance Minister and Deputy Prime Minister. Resolving the crisis will require all the finesse President Kim Young Sam's technocrats can

muster. If they go too slowly, the debt mess will haunt South Korea's companies and banks well into the next century. Push too hard, and they could trigger a massive sell-off of real estate, equity holdings, and businesses by cash-strapped banks and *chaebol*. That, in turn, could set off a deflationary spiral that would push the economy into a recession.

Kim's government is finally taking steps to avert major collapses among the banks. With back-to-back *chaebol* failures prompting U.S. and Japanese banks to cut credit lines or demand hefty premiums on loans, the Bank of Korea has extended \$3.5 billion in emergency foreign-currency loans to domestic banks. And on July 17, the central bank received a request for \$1.1 billion in low-interest loans from Korea First Bank, the nation's second-biggest commercial bank, which lent nearly \$1 billion to Kia. Korea First is carrying roughly \$3.2 billion in nonperforming or risky loans, and it posted a first-half loss of \$417 million, the largest in Korean banking history.

The Finance & Economy Ministry may force the bank to restructure—or merge with a stronger bank. "We are trying to avoid the early stages of a bank panic," says Yoon Chong Won, the ministry's assistant director of financial policy.

On July 10, the Finance Ministry also announced new lending restrictions. The guidelines bar banks from lending more than 45% of their capital base to any one *chaebol*. To discourage high debt levels, they limit tax



LIFE SUPPORT
Car maker Kia is the latest *chaebol* to face bankruptcy

write-offs on interest payments to companies with debt ratios beyond 500%. They also sweeten other write-offs to encourage *chaebol* to pay off loans

selling chunks of their estimated \$1 billion worth of real estate holdings.

These measures follow years of ineffective financial reform, official meddling in lending decisions, and reckless corporate borrowing. According to the ministry, 170 major Korean companies

CANDIDATE LEE: CAN HE CLEAN UP THE MESS?

It was a rowdy, mudslinging affair at the New Korea Party convention on July 21. Yet South Korea's ruling party managed to nominate a strong successor to President Kim Young Sam for a general election in December. He's Lee Chung, a 62-year-old former Supreme Court judge, top election watchdog, and Prime Minister. Lee is expected to be much harder than Kim for economic



The Bad News Keeps Coming

- ▶ Five major conglomerates bankrupt or forced to restructure
- ▶ Banks have more than \$18 billion in bad loans
- ▶ 170 major companies with debt-equity ratios of more than 500%
- ▶ Central bank bailing out faltering lenders

are good rules—and about five years too late,” says Raoul Oberman, a senior manager with McKinsey & Co. in Seoul. Other moves are even less inspiring. Seoul lenders have banded together to give cash-strapped companies such as Jinro, Dainong, and now Kia two-month breaks on debt payments as long as they drastically restructure. Kia, for instance, must now sell off 14 subsidiaries and \$3.5 billion worth of real estate and other assets to pay off its debts in order to stay out of bankruptcy.

DAMAGED GOODS. Trouble is, these assets will fetch far less for the banks now that Kia is viewed as damaged goods and its assets must be sold off in haste. Worse, the banks are expected to extend fresh loans to Kia as part of the deal—possibly throwing more good money after bad. Indeed, there is scant evidence that Seoul bankers are turning off the cash spigot. When the stock market fell by 26% last year, making equity finance unattractive, companies merely increased their short-term borrowing. Nor have

they let up. Korean companies recorded an additional \$53 billion in debt during the first quarter, says the Bank of Korea. That's on top of the \$845 billion already owed to domestic lenders.

Widespread cronyism in the banking establishment and the government ministries may also stall reforms. Soon after the Kia news broke, Korea First Bank President Roo Shee Yul, a former central bank official, visited an old colleague, central bank Governor Lee Kyung Shik, to request financial help. It's not clear whether his old ties will help. But many in the finance sector worry that if troubled players can use contacts to get preferential treatment, they won't carry out the kind of cost-cutting and belt-tightening that is needed. Insists Kwang Soo Shim, assistant governor at Korea Development Bank: “That era is over.”

Kim's government, weakened by political scandal and preoccupied with upcoming December elections, may not be able to rise to the occasion and lead the country out of this mess. Yet until the government stops telling banks what loans to make, until weaker banks merge into stronger ones, and until the *chaebol* clean up their balance sheets, it's going to be one wild ride.

By Brian Bremner in Seoul

have debt-to-equity ratios exceeded 500%. Hanwha, for example, is at 500%, and Ssangyong comes close with 490%. “Over the next three to five years, the Korean economy will have to work off overcapacity in virtually all sectors of industry,” says Rhee Namuh, an economist with Dongbang Peregrine Securities.

Given the extent of the banks' exposure, it's hard to see how the new rules can reverse what decades of easy lending have wrought. “These

including reducing the dominance of the *chaebol* and opening up to foreign competition. And he is open about the pain it will cost Korea's fortress economy. “The new era will be one of unlimited competition,” he told delegates at the Olympic stadium. In the past, South Korean presidents handpicked their successors. This time, Kim remained above the fray, and new rules gave the 11,000-plus delegates more say. The only intrigue came when Kim leveled unsubstantiated charges that Lee had bought votes to bolster his bid. Yet the uproar passed. And Lee defeated his key rival, 49-year-old

provincial governor Rhee In Je—a blustery man who claimed Seoul could also bid for a spacecraft on Mars. Odds are that Lee will win the presi-



FRESH IDEAS

“The new era will be one of unlimited competition,” says Lee Hoi Chung

dency for the next five-year term. Lee became something of a hero in 1994 when he quit the ceremonial post of Prime Minister after run-ins with Kim over his autocratic style. “He's very clean and really what the country needs,” says Won Jae Cho, 47, a former student protester. Given the economic challenges facing South Korea's windied Tiger economy, the nation certainly hopes so.

By Brian Bremner in Seoul

At your age, with your high cholesterol, what's your risk of a first heart attack?

If you have high cholesterol, figure your risk of a first heart attack.

Fill in your points for each risk factor.

- | | |
|--|---|
| ☐ Age: Men
0 pts. Less than 35 2 pts. 40 to 48 4 pts. 54+
1 pt. 35 to 39 3 pts. 49 to 53 | ☐ Total Cholesterol Level:
0 pts. Less than 240 mg/dL
1 pt. 240 to 315 mg/dL
2 pts. More than 315 mg/dL |
| ☐ Age: Women
0 pts. Less than 42 2 pts. 45 to 54 4 pts. 74+
1 pt. 42 to 44 3 pts. 55 to 73 | ☐ HDL Level (good cholesterol):
0 pts. 39 to 59 mg/dL
1 pt. 30 to 38 mg/dL
2 pts. Under 30 mg/dL
-1 pt. Over 60 mg/dL |
| ☐ Family History:
2 pts. My family has a history of heart disease or heart attacks before the age of 60 | ☐ Blood Pressure:
I don't take blood pressure medication; my blood pressure is:
(Use your top or higher blood pressure number)
0 pts. Less than 140 mmHg
1 pt. 140 to 170 mmHg
2 pts. Greater than 170 mmHg
(or)
1 pt. I am currently taking blood pressure medication |
| ☐ Inactive Lifestyle:
1 pt. I rarely exercise or do anything physically demanding | |
| ☐ Weight:
1 pt. I'm more than 20 lbs. over my ideal weight | |
| ☐ Smoking:
1 pt. I'm a smoker | |
| ☐ Diabetic:
1 pt. Male Diabetic
2 pts. Female Diabetic | |

☐ **Total Points**

If you scored 4 points or more, you could be at above average risk of a first heart attack compared to the general adult population. The more points you score, the greater your risk.

If you have already had a heart attack or have heart disease, your heart attack risk is significantly higher. **Only your doctor can evaluate your risk and recommend treatment plans to reduce your risk.** If you don't know your cholesterol level or blood pressure, ask your doctor if your levels should be checked.

Provided as an educational service from Bristol-Myers Squibb Company.

American Heart
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*Fighting Heart Disease
and Stroke*



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PRAVACHOL, in combination with diet, is proven to reduce the risk of a first heart attack, reduce the risk of death from heart disease, and reduce the need for surgery to clear blocked coronary

arteries (such as bypass or angioplasty) based on a landmark study including over 6,500 males with high cholesterol and no evidence of heart disease. Because PRAVACHOL is a prescription

drug, you should ask your doctor or healthcare professional if PRAVACHOL is right for you. Some mild side effects, such as slight rash or stomach upset, occur in about 2-4% of patients.

PRAVACHOL[®]

Proven to help prevent first heart attacks in people with high cholesterol.

PRAVACHOL is the only cholesterol-lowering drug of its kind proven to help prevent first heart attacks. And the fact is, up to 33% of people do not survive their first heart attack. Improving your diet and exercise is an important first step, but may not be enough. So ask

your doctor about PRAVACHOL. It reduces the risk of a first heart attack and the need for surgery to clear blocked coronary arteries. PRAVACHOL has been prescribed by doctors for millions of men and women worldwide. It could help you live a longer, healthier life.

Ask your doctor if PRAVACHOL is right for you. Or call **800-PREVENT** for information on *first heart attack prevention* including a free brochure from the American Heart Association. All provided by Bristol-Myers Squibb.

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PRAVACHOL should not be taken by women who are pregnant or nursing, people who are allergic to any of its ingredients or by anyone with liver disease. Your doctor may perform simple

blood tests to check your liver function before and during treatment with PRAVACHOL. Muscle pain or weakness could be a sign of a rare but serious side effect and should be reported to your

doctor right away. Be sure your doctor knows about other medications you may be taking in order to avoid any possible serious drug interactions. Please see important information on the next page.

PRAVACHOL
pravastatin sodium 20 mg
tablets

**Proven to help prevent
first heart attacks.**

PRAVACHOL®

Pravastatin Sodium Tablets

CONTRAINDICATIONS

elevations in liver function tests (see **WARNINGS: Pregnancy and lactation**). Atherosclerosis is a chronic process and discontinuation of lipid-lowering drugs during pregnancy should have little impact on the outcome of long-term therapy of primary hypercholesterolemia. Cholesterol and other products of cholesterol biosynthesis are essential components for fetal development (including synthesis of steroids and cell membranes). Since HMG-CoA reductase inhibitors decrease cholesterol synthesis and possibly the synthesis of other biologically active substances derived from cholesterol, they may cause fetal harm when administered to pregnant women. Therefore, HMG-CoA reductase inhibitors are contraindicated during pregnancy and in nursing mothers. **Pravastatin should be administered to women of childbearing age only when such patients are highly unlikely to conceive and have been informed of the potential hazards.** If the patient becomes pregnant while taking this class of drug therapy should be discontinued and the patient apprised of the potential hazard to the fetus.

WARNINGS: Liver Enzymes: HMG-CoA reductase inhibitors, like some other lipid-lowering therapies, have been associated with biochemical abnormalities of liver function. Increases of serum transaminase (ALT, AST) values have been more than 3 times the upper limit of normal occurring on 2 or more (not necessarily sequential) occasions have been reported in 1.3% of patients treated with pravastatin in the US over an average period of 18 months. These abnormalities were not associated with cholestasis and did not appear to be related to treatment duration. In those patients in whom these abnormalities were believed to be related to pravastatin and who were discontinued from therapy, the transaminase levels usually fell slowly to pretreatment levels. These biochemical findings are usually asymptomatic, although worldwide experience indicates that abnormal weakness, and/or abdominal pain may also be present in rare patients. In the largest long-term placebo-controlled clinical trial with pravastatin (Pravastatin Primary Prevention Study, see **Clinical Pharmacology**), the overall incidence of AST and/or ALT elevations to greater than three times the upper limit of normal was 1.05% in the pravastatin group as compared to 0.75% in the placebo group. One (0.03%) pravastatin-treated patient and 2 (0.06%) placebo-treated patients were discontinued because of transaminase elevations. Of the patients with normal liver function at week 12, three of 2875 treated with pravastatin (0.10%) and one of the 2919 placebo patients (0.03%) had elevations of AST greater than three times the upper limit of normal on two consecutive measurements and/or discontinued due to elevations in transaminase levels during the 4.8 years (median treatment) of the study. **It is recommended that liver function tests be performed prior to and at 12 weeks following initiation of therapy or the elevation of dose.** Patients who develop increased transaminase levels or signs and symptoms of liver disease should be monitored with a second liver function evaluation to confirm the finding and be followed thereafter with frequent liver function tests until the abnormalities return to normal. Should an increase in AST or ALT of three times the upper limit of normal or greater persist, withdrawal of pravastatin therapy is recommended. Active liver disease or unexplained transaminase elevations are contraindications to the use of pravastatin (see **CONTRAINDICATIONS**). Caution should be exercised when pravastatin is administered to patients with a history of liver disease or heavy alcohol ingestion (see **CLINICAL PHARMACOLOGY: Pharmacokinetics/Metabolism**). Such patients should be closely monitored, started at the lower end of the recommended dosing range, and titrated to the desired therapeutic effect. **Skeletal Muscle:** Rare cases of rhabdomyolysis with acute renal failure secondary to myoglobinuria have been reported with pravastatin and other drugs in this class. Uncomplicated myalgia has also been reported in pravastatin-treated patients (see **ADVERSE REACTIONS**). Myopathy, defined as muscle aching or muscle weakness in conjunction with increases in creatine phosphokinase (CPK) values to greater than 10 times the upper normal limit, was rare (< 0.1%) in pravastatin clinical trials. Myopathy should be considered in any patient with diffuse myalgias, muscle tenderness or weakness, and/or marked elevation of CPK. Patients should be advised to report promptly unexplained muscle pain, tenderness or weakness, particularly if accompanied by malaise or fever. **Pravastatin therapy should be discontinued if markedly elevated CPK levels occur or myopathy is diagnosed or suspected.** Pravastatin therapy should also be temporarily withheld in any patient experiencing an acute or serious condition predisposing to the development of renal failure secondary to rhabdomyolysis, e.g., sepsis; hypotension; major surgery; trauma; severe metabolic, endocrine, or electrolyte disorders; or uncontrolled epilepsy. The risk of myopathy during treatment with another HMG-CoA reductase inhibitor is increased with concurrent therapy with either erythromycin, cyclosporine, niacin, or fibrates. However, neither myopathy nor significant increases in CPK levels have been observed in three reports involving a total of 100 post-transplant patients (24 renal and 76 cardiac) treated for up to two years concurrently with pravastatin 10-40 mg and cyclosporine. Some of these patients also received other concomitant immunosuppressive therapies. In one single-dose study, pravastatin levels were found to be increased in cardiac transplant patients receiving cyclosporine. Further, in clinical trials involving small numbers of patients who were treated concurrently with pravastatin and niacin, there were no reports of myopathy. Also, myopathy was not reported in a trial of combination pravastatin (40 mg/day) and gemfibrozil (1200 mg/day) although 4 of 75 patients in the combination showed marked CPK elevations versus one of 73 patients receiving placebo. There was a trend toward more frequent CPK elevations and patient withdrawals due to musculoskeletal symptoms in the group receiving combined treatment as compared with the groups receiving placebo, gemfibrozil, or pravastatin monotherapy (see **PRECAUTIONS: Drug Interactions**). The use of fibrates alone may occasionally be associated with myopathy. The combined use of pravastatin and fibrates should be avoided unless the benefit of further alterations in lipid levels is likely to outweigh the increased risk of this drug combination.

PRECAUTIONS: General: Pravastatin may elevate creatinine phosphokinase and transaminase levels (see **ADVERSE REACTIONS**). This should be considered in the differential diagnosis of chest pain in a patient on therapy with pravastatin. **Homozygous Familial Hypercholesterolemia:** Pravastatin has not been evaluated in patients with rare homozygous familial hypercholesterolemia. In this group of patients, it has been reported that HMG-CoA reductase inhibitors are less effective because the patients lack functional LDL receptors. **Renal Insufficiency:** A single 20 mg oral dose of pravastatin was administered to 24 patients with varying degrees of renal impairment (as determined by creatinine clearance). No effect was observed on the pharmacokinetics of pravastatin or its 3 α -hydroxy isomeric metabolite (SQ 31 906). A small increase was seen in mean AUC values and half-life ($t_{1/2}$) for the inactive enzymatic ring hydroxylation metabolite (SQ 31 945). Given this small sample size, the dosage administered, and the degree of individual variability, patients with renal impairment who are receiving pravastatin should be closely monitored. **Information for Patients:** Patients should be advised to report promptly unexplained muscle pain, tenderness or weakness, particularly if accompanied by malaise or fever. **Drug Interactions: Immunosuppressive Drugs, Gemfibrozil, Niacin (Nicotinic Acid), Erythromycin:** See **WARNINGS: Skeletal Muscle**. **Antipyrene:** Since concomitant administration of pravastatin had no effect on the clearance of antipyrene, interactions with other drugs metabolized via the same hepatic cytochrome isozymes are not expected. **Cholestyramine/Colestipol:** Concomitant administration resulted in an approximately 40 to 50% decrease in the mean AUC of pravastatin. However, when pravastatin was administered 1 hour before or 4 hours after cholestyramine or 1 hour before colestipol and a standard meal, there was no clinically significant decrease in bioavailability or therapeutic effect (see **DOSE AND ADMINISTRATION: Concomitant Therapy**). **Warfarin:** In a study involving 10 healthy male subjects given pravastatin and warfarin concomitantly for 6 days, bioavailability parameters at steady state for pravastatin (parent compound) were not altered. Pravastatin did not alter the plasma protein-binding of warfarin. Concomitant dosing did increase the AUC and C_{max} of warfarin but did not produce any changes in its anticoagulant action (i.e., no increase was seen in mean prothrombin time after 6 days of concomitant therapy). However, bleeding and extreme prolongation of prothrombin time has been reported with another drug in this class. Patients receiving warfarin-type anticoagulants should have their prothrombin times closely monitored when pravastatin is initiated or the dosage of pravastatin is changed. **Cimetidine:** The AUC for pravastatin when given with cimetidine was not significantly different from the AUC for pravastatin when given alone. A significant difference was observed between the AUC's for pravastatin when given with cimetidine compared to when administered with antacid. **Digoxin:** In a crossover trial involving 18 healthy male subjects given pravastatin and digoxin concurrently for 9 days, the bioavailability parameters of digoxin were not affected. The AUC of pravastatin tended to increase, but the overall bioavailability of pravastatin plus its metabolites SQ 31 906 and SQ 31 945 was not altered. **Cyclosporine:** Some investigators have measured cyclosporine levels in patients on pravastatin and to date, these results indicate no clinically meaningful elevations in cyclosporine levels. In one single-dose study, pravastatin levels were found to be increased in cardiac transplant patients receiving cyclosporine. **Gemfibrozil:** In a crossover study in 20 healthy male volunteers given concomitant single doses of pravastatin and gemfibrozil, there was a significant decrease in urinary excretion and protein binding of pravastatin. In addition, there was a significant increase in AUC, C_{max}, and T_{max} for the pravastatin metabolite SQ 31 906. Combination therapy with pravastatin and gemfibrozil is generally not recommended. In interaction studies with aspirin, antacids 1 hour prior to PRAVACHOL, cimetidine, niacin, acid or probucol no statistically significant differences in bioavailability were seen when PRAVACHOL (pravastatin sodium) was administered. **Other Drugs:** During clinical trials, no noticeable drug interactions were reported when PRAVACHOL was added to diuretics, antihypertensives, digitalis ACE inhibitors, calcium channel blockers, beta-blockers, or nitroglycerin. **Endocrine Function:** HMG-CoA reductase inhibitors interfere with cholesterol synthesis and lower circulating cholesterol levels and, as such, might theoretically blunt adrenal or gonadal steroid hormone production. Results of clinical trials with pravastatin in males and post-menopausal females were inconsistent with regard to possible effects of the drug on basal steroid hormone levels. In a study of 21 males, the mean testosterone response to human chorionic gonadotropin was significantly reduced ($p < 0.04$) after 16 weeks of treatment with 40 mg of pravastatin. However, the percentage of patients showing a $\geq 50\%$ rise in plasma testosterone after human chorionic gonadotropin stimulation did not change significantly after therapy in these patients. The effects of HMG-CoA reductase inhibitors on spermatogenesis and fertility have not been studied in adequate numbers of patients. The effects, if any, of pravastatin on the pituitary-gonadal axis in pre-menopausal females are unknown. Patients treated with pravastatin who display clinical evidence of endocrine dysfunction should be evaluated appropriately. Caution should also be exercised if an HMG-CoA reductase inhibitor or other agent used to lower cholesterol levels is administered to patients also receiving other drugs (e.g., ketoconazole, spironolactone, cimetidine) that may diminish the levels or activity of steroid hormones. **CNS Toxicity:** CNS vascular lesions, characterized by perivascular hemorrhage and edema and mononuclear cell infiltration of perivascular space, were seen in dogs treated with pravastatin at a dose of 25 mg/kg/day a dose that produced a plasma drug level about 50 times higher than the mean drug level in humans taking 40 mg/day. Similar CNS vascular lesions have been observed with several other drugs in this class. A chemically similar drug in this class produced optic nerve degeneration (Wallerian degeneration of retinoganglionic fibers) in clinically normal dogs in a dose-dependent fashion starting at 60 mg/kg/day a dose that produced mean plasma drug levels about 30 times higher than the mean drug level in humans taking the highest recommended dose (as measured by total enzyme inhibitory activity). This same drug also produced vestibular colic (ear wax-like degeneration and retinal ganglion cell chromatolysis in dogs treated for 14 weeks at 180 mg/kg/day, a dose

Impairment of Fertility: In a 2-year study in rats fed pravastatin at doses of 10, 30, or 100 mg/kg body weight, there was evidence of hepatocellular carcinomas in males at the highest dose (at 25, 100, and 400 mg/kg body weight, there were up to 10 times the human dose (HD) on a mg/kg body weight basis, serum drug levels were only 6 to 10 times higher than at 100 mg/kg body weight, as measured by AUC. The oral administration of 10, 30, or 100 mg/kg (producing plasma drug levels approximately 0.5 to 5.0 times the human drug levels at 40 mg) of pravastatin to mice for 22 months resulted in a statistically significant increase in the incidence of malignant lymphomas in treated females when all treatment groups were pooled and compared to controls ($p < 0.05$). The incidence was not dose-related and male mice were not affected. A chemically similar drug in this class was administered to mice for 72 weeks at 25, 100, and 400 mg/kg body weight, with results in mean serum drug levels approximately 3, 15, and 33 times higher than the mean human serum drug concentration (as total inhibitory activity) after a 40 mg oral dose. Liver carcinomas were significantly increased in high-dose females, mid- and high-dose males, with a maximum incidence of 90 percent in males. The incidence of adenomas of the liver significantly increased in mid- and high-dose females. Drug treatment also significantly increased the incidence of adenomas in mid- and high-dose males and females. Adenomas of the eye Harderian gland (a gland of the eye of rodents) were significantly higher in high-dose mice than in controls. No evidence of mutagenicity was observed *in vitro*, with or without liver metabolic activation, in the following studies: microbial mutagen tests, using mutant strains of *Salmonella typhimurium*, *Escherichia coli*, a forward mutation assay in L5178Y TK +/– mouse lymphoma cells, a chromosomal aberration test in hamster cells, and a gene conversion assay using *Saccharomyces cerevisiae*. In addition, there was no evidence of mutagenicity either a dominant lethal test in mice or a micronucleus test in mice. In a study in rats, with daily doses up to 500 mg pravastatin did not produce any adverse effects on fertility or general reproductive performance. However, in a study with another HMG-CoA reductase inhibitor, there was decreased fertility in male rats treated for 34 weeks at 25 mg/kg body weight, although this effect was not observed in a subsequent fertility study when this same dose was administered for 11 weeks, entire cycle of spermatogenesis, including epididymal maturation. In rats treated with this same reductase inhibitor at 100 mg/kg/day, seminiferous tubule degeneration (necrosis and loss of spermatogenic epithelium) was observed. Although not with pravastatin, two similar drugs in this class caused drug-related testicular atrophy, decreased spermatogenesis, spermatocytic degeneration, and giant cell formation in dogs. The clinical significance of these findings is unclear. **Pregnancy Category X.** See **CONTRAINDICATIONS**. Safety in pregnant women has not been established. Pravastatin was teratogenic in rats at doses up to 1000 mg/kg daily or in rabbits at doses of up to 50 mg/kg daily. These doses resulted in (rabbit) or 240x (rat) the human exposure based on surface area (mg/m²). However, in studies with another HMG-CoA reductase inhibitor, skeletal malformations were observed in rats and mice. There has been one report of severe congenital bony deformity, tracheo-esophageal fistula, and anal atresia (VACTERL association) in a baby born to a woman who took and HMG-CoA reductase inhibitor with dextroamphetamine sulfate during the first trimester of pregnancy. PRAVACHOL (pravastatin sodium) should be administered to women of child-bearing potential only when such patients are highly unlikely to conceive and have been informed of the potential hazards. If the woman becomes pregnant while taking PRAVACHOL (pravastatin sodium), it should be discontinued and the patient advised again as to the potential hazards to the fetus. **Nursing Mother:** Small amounts of pravastatin is excreted in human breast milk. Because of the potential for serious adverse reactions in nursing infants, women taking PRAVACHOL should not nurse (see **CONTRAINDICATIONS**). **Pediatric Use:** Safety and effectiveness in individuals less than 18 years old have not been established. Hence, treatment in patients less than 18 years old is not recommended at this time.

ADVERSE REACTIONS: Pravastatin is generally well tolerated, adverse reactions have usually been mild and transient. In month long placebo-controlled trials, 1.7% of pravastatin-treated patients and 1.2% of placebo-treated patients were discontinued from treatment because of adverse experiences attributed to study drug therapy, this difference was statistically significant. In long-term studies, the most common reasons for discontinuation were asymptomatic serum transaminase increases and mild, non-specific gastrointestinal complaints. During clinical trials the overall incidence of adverse events in the elderly was not different from the incidence observed in younger patients. **Adverse Clinical Events:** All adverse clinical events (regardless of attribution) reported in more than 2% of pravastatin-treated patients in the placebo-controlled trials are identified in the table below, also shown are the percentages of patients in whom these medical events were believed to be related or possibly related to the drug.

Body System/Event	All Events		Events Attributed to Study Drug	
	Pravastatin (N = 900) %	Placebo (N = 411) %	Pravastatin (N = 900) %	Placebo (N = 411) %
Cardiac Chest Pain	1.1	3.4	1.1	0.0
Dermatologic Rash	1.1	1.1	1.3	0.9
Gastrointestinal				
Diarrhea	5.6	2.0	1.9	3.4
Abdominal Pain	4.4	2.4	3.9	1.9
Constipation	4.0	7.1	2.4	5.1
Fatulence	3.3	3.6	2.7	3.4
Heartburn	1.9	2.0	1.7	1.7
General				
Fatigue	3.8	3.4	1.9	1.0
Chest Pain	3.7	1.9	0.3	0.2
Influenza	1.1	1.1	0.0	0.0
Musculoskeletal				
Localized Pain Myalgia	1.1	1.1	1.4	1.5
Nervous System				
Headache	6.2	3.9	1.7*	0.2
Dizziness	3.3	3.2	1.0	0.5
Renal/Genitourinary				
Urinary Abnormality	2.4	2.9	0.7	1.4
Respiratory				
Rhinitis	4.1	4.1	0.0	1.2
	1.7	1.7	0.1	0.5

*Statistically significantly different from placebo

In the Pravastatin Primary Prevention Study (West of Scotland Coronary Prevention Study) (see **CLINICAL PHARMACOLOGY: Clinical Studies**) involving 6595 patients treated with pravastatin (pravastatin sodium) (N = 3702) or placebo (N = 3293) adverse event profile in the pravastatin group was comparable to that of the placebo group over the median 4.8 years of study. The following effects have been reported with drugs in this class, not all the effects listed below have necessarily been associated with pravastatin therapy. **Skeletal myopathy/rhabdomyolysis:** arthralgia, neurological dysfunction of certain nerves (including alteration of taste, impairment of extra-ocular movement, facial paresis), tremor, vertigo, memory impairment, peripheral neuropathy, peripheral nerve palsy, anxiety, insomnia, depression. **Hypersensitivity Reaction:** apparent hypersensitivity syndrome has been reported rarely which has included one or more of the following: fever, anaphylaxis, angioedema, lupus erythematosus-like syndrome, polymyalgia rheumatica, dermatomyositis, vasculitis, purpura, thrombocytopenia, leukopenia, hemolytic anemia, positive ANA, ESR increase, eosinophilia, arthritis, arthralgia, joint aches, photosensitivity, liver chills, flushing, malaise, dyspnea, toxic epidermal necrolysis, erythema multiforme, incl. Stevens-Johnson syndrome. **Gastrointestinal:** pancreatitis, including chronic acute hepatitis, cholestatic jaundice, fatty change in liver, and, rarely, cirrhosis, fulminant hepatic necrosis, and hepatoma, anorexia, vomiting, *S. aureus* pruritus. A variety of skin changes (e.g. nodules, discoloration, dryness of skin/mucous membranes, changes to hair/nails) have been reported. **Reproductive:** gynecomastia, loss of libido, erectile dysfunction. Eye progression of cataracts (lens opacities) ophthalmoplegia. **Laboratory Abnormalities:** elevated transaminases, alkaline phosphatase, and bilirubin, thyroid function abnormalities. **Laboratory Test Abnormalities:** increases in serum transaminase (ALT, AST) values and CPK have been observed (see **WARNINGS**). Transient, asymptomatic eosinophilia has been reported. Eosinophil counts usually return to normal despite continued therapy. Anemia, thrombocytopenia, and leukopenia have been reported with HMG-CoA reductase inhibitors. **Concomitant Therapy:** Pravastatin has been administered concurrently with cholestyramine, colestipol, niacin, acid, probucol and gemfibrozil. Preliminary data suggest that the addition of either probucol or gemfibrozil to therapy with pravastatin is not associated with greater reduction in LDL-cholesterol than that achieved with lovastatin alone. No adverse reactions unique to the combination or in addition to those previously reported for each alone have been reported. Myopathy and rhabdomyolysis (with or without acute renal failure) have been reported when an HMG-CoA reductase inhibitor was used in combination with immunosuppressive drugs: gemfibrozil, erythromycin, or cyclosporine. Lowering doses of niacin, acid, and concomitant therapy with HMG-CoA reductase inhibitors and these agents are generally recommended (see **WARNINGS: Skeletal Muscle** and **PRECAUTIONS: Drug Interactions**).

OVERDOSEAGE: To date, there are two reported cases of overdose with pravastatin, both of which were asymptomatic and not associated with clinical laboratory abnormalities. If an overdose occurs, it should be treated symptomatically and supportive measures should be instituted as required.

CAUTION: Federal (USA) law prohibits dispensing without prescription.



MOUSEKETEER: *Beijing is refusing to release new Disney movies and videos*

signing on. But such efforts "take time," says Maria Miu, a Disney executive in Hong Kong.

The uproar could also affect Sony Corp.'s picture-making division. Sony is distributing another film, *Seven Years in Tibet*, starring Brad Pitt. "The company is expecting some difficulties," says an industry analyst based in China. Sources say Sony is concerned but hopes the film's adventure theme will not be as controversial as Disney's *Kundun*.

TOO "DEFIANT"? Even in the best of times, Western entertainment giants face major hurdles in China, from copyright infringement to resistance from the communist

bureaucracy. It took Children's Television Workshop more than two years to negotiate its Shanghai-produced version of *Sesame Street*. And China's recent promotion of its "spiritual civilization" is partly aimed at protecting local industries from Hollywood and other Western influences.

But Disney appears to be in the hottest water of all. Disney "should not have been so defiant" on a film China considers "taboo," says one seasoned Asian TV executive, arguing that the company could have shown more sensitivity. "They just don't know how to approach the Chinese." For now, the exact release date for *Kundun* has not been set. And, informed sources say, Disney officials are not expecting a thaw

INA

AS DISNEY BECOME THE FORBIDDEN STUDIO?

ed by a Tibet film, Beijing freezes the giant's new projects

was the kind of publicity Walt Disney Co. never wanted. When the Hollywood giant decided last year to duce and distribute *Kundun*, a film the Dalai Lama, the Tibetan spiritual leader, Beijing officials erupted, furious that foreigners were publicizing the se of Tibet.

Yet Disney stuck with the project, ich superagent Michael Ovitz acquired the company in his short, disastrous ure as Disney president. Now, the ent of the retribution is becoming ar: a ban on new Disney ventures in ina, the world's biggest undeveloped dia market. Disney "has indicated a s of respect for Chinese sovereignty," s Yang Buting, a vice-director of the nistry of Radio, Film & Television. ecause of this, we are thinking over 'business with Disney."

Chilling comments. The propaganda partment of the Communist Party's ntral Committee is so angry that Dis's main projects in China are "frozen," s an industry analyst. The company s a few ventures up and running. But sney wants greater access for the Dis-

ney Channel through cable TV: China's fledgling TV market is already generating \$4 billion a year in advertising revenues. Those efforts are going nowhere, industry sources say. Sources also say the Chinese are not releasing new Disney films and that the company has not landed a distribution deal for its videotapes.

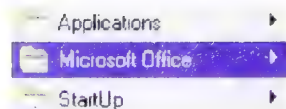
RETRIBUTION Plans to expand TV access for the Disney Channel and the China Disney Club are going nowhere. Meanwhile, Sony's upcoming Tibet movie could land it in hot water, too

Disney officials are playing it cool. "We continue to do business in China," says spokesman John Dreyer. "The Chinese government has expressed their concerns about *Kundun*," he adds. "We continue to talk with them." The company also points out that 12 TV stations carry the China Disney Club, a family show launched in 1995. Disney says it is talking with provincial TV stations about

until the film flap is over, which they figure will be in the first half of 1998 at the earliest. Even that scenario may be wishing on a star.

By Joyce Barnathan in Hong Kong, with Matt Miller in Shanghai and Dexter Roberts in Beijing

An interview with Disney Chairman Michael D. Eisner appears on page 73.



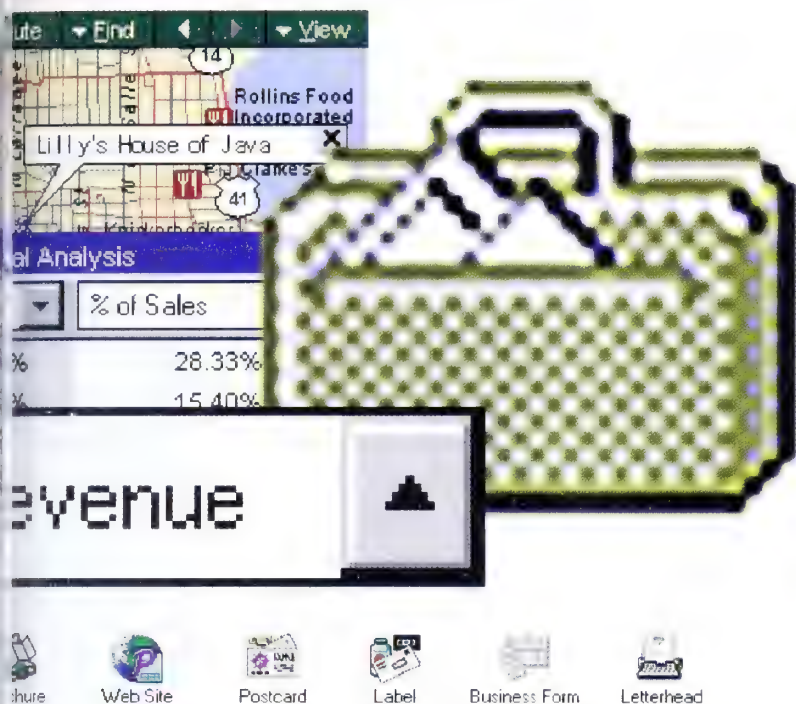
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GERMANY

A BREAKTHROUGH IN BAVARIA

J.P. Morgan puts together a model banking merger

The deal was a long time coming. Local wags say the two Munich-based banks, founded in the 19th century, have been talking merger almost ever since. But the agreement finally reached on July 21 by Bayerische Vereinsbank and Bayerische Hypotheken- und Wechselbank, creating a \$412 billion behemoth second in Germany only to Deutsche Bank, looks as if it was worth the wait.

Unusually beneficial to shareholders, the merger involves a rare unraveling of the cross-shareholdings that protect many German companies from outside financial pressure. At the same time, the deal avoids severe job losses and allows shareholders to partially escape Germany's 50%-plus capital-gains tax. If it works, it could be a model for other big German financial institutions, which carry huge equity investments on their books at a fraction of market value.

BIG OBSTACLES. Unloading such holdings would free up cash to earn higher returns—or buy up other banks. “There’s no question that these cross-shareholdings have to be diminished, given the pressure on companies to produce higher returns,” says Walter A. Gubert, head of European operations at J.P. Morgan & Co., which engineered the merger. Among the candidates to sell off assets and use them to acquire smaller rivals: Deutsche Bank, Dresdner Bank, and insurance giant Allianz. Deutsche Bank Chief Executive Rolf E. Breuer calls the deal a potential “coup” if it works.

The Munich merger has overcome big obstacles. With 40,200 employees, the two banks are among Bavaria's biggest employers. The deal also pitted two fi-



A DEAL DESIGNED TO PLEASE

SHAREHOLDERS

Vereinsbank will pay for part of Hypo-Bank with 19.3 million Allianz shares. The tax-free transaction boosts the deal's overall value.

ALLIANZ

The deal diversifies insurance giant Allianz' shareholder base, and helps guard against a takeover by archrival Deutsche Bank.

POLITICIANS

By keeping Frankfurt banks at bay, the merger will ensure that Munich retains its financial clout—and jobs.

financial powerhouses against each other. Deutsche Bank last year took a 5.2% stake in Vereinsbank, a move analysts thought signaled an eventual takeover bid. On the other side were Deutsche

Bank rival Allianz and its ally Munich Re, which have minority stakes in Bavarian banks. They wanted to ensure a Deutsche takeover didn't happen.

Enter J.P. Morgan. Representing both banks, Morgan spent more than a year reconciling conflicting interests. One key to the deal's success was a two-tier structure that benefited the banks' and Allianz' shareholders. Vereinsbank will use its 19.3 million Allianz shares to buy the first 45% of Hypo-Bank. Vereinsbank's sell-off of Allianz shares is unusual in Germany, where such cross-holdings were until fairly recently not even disclosed. “The fact that it was sold and the benefits distributed to shareholders is a real breakthrough,” says Neil Crowder, Goldman Sachs analyst in London.

And because the transaction involves shares, under German law Vereinsbank is exempt from capital-gains tax on the sale of its Allianz stock. The Vereinsbank transfer thus makes the deal worth substantially more than what analysts had expected. Hypo, Vereins, and Allianz shares all soared on the announcement.

EVERYONE WINS: Workers and shareholders come out ahead

The political maneuvering was delicate, too. The banks had to reassure Bavarian Prime Minister Edmund Stoiber that it would be a “soft” deal, says Ulrich Wilhelm, Stoiber's spokesman, with staff cuts coming from the combined banks' normal attrition of about 2,000 workers per year. But the big selling point was that it would keep the banks out of the hands of Frankfurt-based banks, such as Deutsche and Dresdner. “We were absolutely interested in not having a bank from outside Munich involved,” Wilhelm says.

Given these exigencies, the merger won't save anything like what a U.S. bank merger of similar size would. The principals put the cost savings at about \$560 million annually after five years, or about 12% of the merged institution's total costs. That's about half the average in the U.S., where layoffs cut deeper and come faster. And the deal, scheduled to be completed next spring, could still run into trouble. Vereinsbank's chief executive, Albrecht Schmidt, and Hypo-Bank CEO Eberhard Martini plan to run the new bank jointly at first—a recipe for conflict.

Nonetheless, the deal represents a coup for all participants, especially for one of Europe's most hidebound financial markets. German competitors are sure to be watching the outcome.

By Thane Peterson in Frankfurt



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EDITED BY JOHN TEMPLEMAN

IS EUROPE ELBOWING THE U.S. OUT OF SOUTH AMERICA?

The U.S. has long regarded South America as its business backyard. But while Congress and the Clinton Administration dither over moves to create a free-trade bloc covering the hemisphere by 2005, the European Union is barging in and bolstering its economic links with the region.

Europeans have won many of the top privatization deals since the early 1990s, when governments in South America began opening their markets. Now, they are swooping into private-sector businesses from banking to food. "We can't be left on the sidelines," frets U.S. Commerce Secretary William M. Daley.

FREE-TRADE FACTIONS. While Washington is focused almost exclusively on the 2005 deadline to create the Free Trade Area of the Americas (FTAA), the EU is adopting a piecemeal approach that is winning friends. By 1999, the EU and Mercosur, led by Brazil and Argentina, are expected to begin talks that could lead to a free-trade area. The U.S., meanwhile, hasn't yet agreed with Latin American nations on the objectives, structure, or approach of the FTAA talks scheduled to start next year.

Europe is making diplomatic gains, too. While President Bill Clinton will not make his first trip to South America until October, European and Latin American leaders visit each other often. French President Jacques Chirac and Spanish Premier José María Aznar both toured the region this year, and Argentine President Carlos Menem went to Germany in May and invited German companies to take part in Argentina's remaining privatizations.

Chile, for one, seems close to throwing in the towel with Washington. Its bid to join NAFTA has been stalled for more than two years while Clinton tries to get fast-track negoti-

ating authority from Congress. Fed up with the wait, Chile has moved closer to Europe and its own neighbors. It now joined Mercosur as an associate member. And in June started formal talks on a separate trade deal with the EU.

Of course, the U.S. is still Latin America's biggest overall trade and investment partner because of Mexico's NAFTA membership. But Europe is pulling ahead in Mercosur, which excludes Mexico. Mercosur's two-way trade with the EU totaled \$43 billion in 1995, vs. \$29 billion with the U.S.

Europe is winning the race for megabuck contracts to build South America's infrastructure. Spain's Telefónica de

España, for example, has spent \$5 billion buying telephone companies in Brazil, Chile, Peru, and Argentina where France Télécom and STET Italy are active, too. France's Electricité de France and Lyonnaise des Eaux have taken over state-owned utilities. And Spanish energy company Endesa owns electric companies in Argentina and Peru.

SUPERMARKETS. In some countries Europeans have built enormous power bases in the corporate sector. In Brazil, South America's biggest market so far, 7 of the 10 largest private companies are European-owned, while two are controlled by Americans. Europeans dominate huge swaths of the economy, from auto makers Volkswagen and Fiat to French supermarket chain Carrefour and Anglo-Dutch personal-care products group Gessy Lever.

Not everything between the EU and Latin America is hunky-dory. Brazil, for example, is complaining about European barriers to its coffee exports. But the EU has done enough groundwork to protect its interests if the U.S. and South America ever succeed in setting up a trade bloc.

By Ian Katz in São Paulo



IN RIO: Europe's corporate presence is huge

GLOBAL WRAPUP

MOSCOW POWER STRUGGLES

► A vicious power struggle is raging in Moscow among bankers, businessmen, and reform politicians who backed Boris Yeltsin's reelection bid last year. With the threat of a communist resurgence—the glue that bound them together—gone, they are at each others' throats fighting for political and financial power.

The conflict is turning violent. On July 21, a shot was fired into the home of Central Bank Chairman Sergei Dubinin. No one was injured. Earlier this

month, Dubinin accused former Deputy Finance Minister Andrei Vavilov and major banks of mishandling over \$500 million in government funds. Vavilov, an ally of Prime Minister Viktor S. Chernomyrdin, was bounced from his post by reformer Anatoly B. Chubais. He quickly found a job with MFK Bank, a unit of Oneximbank.

Moscow insiders read the probe into Vavilov as an attack on Oneximbank and former First Deputy Prime Minister Vladimir Potanin, who now runs it. Other financial bigwigs, notably Security Council Deputy Secretary Boris

Berezovsky, want to clip Potanin's wings and stymie his acquisition binge. Oneximbank is locked in battle with rival groups for control of both Rosneft, the last big oil company to be privatized, and Svyazinvest, a telecom outfit whose holdings include a 38% stake in long-distance carrier Rostelecom.

Meanwhile, Potanin seems to have lost the protection of Chubais, who is mainly preoccupied with consolidating his political power. In the new Russia, where connections count far more than entrepreneurship, that's dangerous.

By Patricia Kranz in Moscow

The 1998 Business Week Planner.

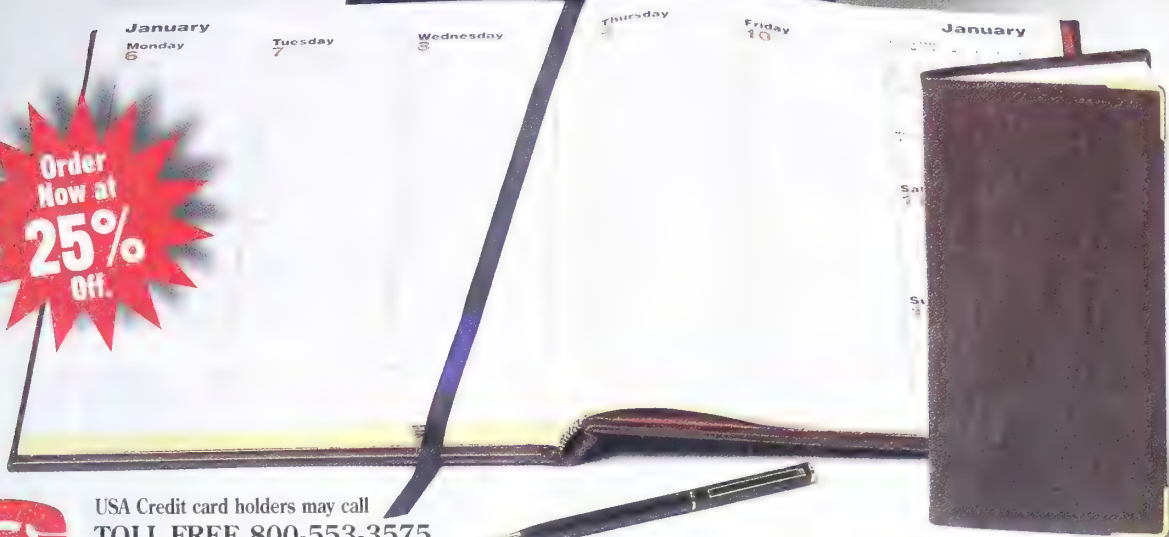
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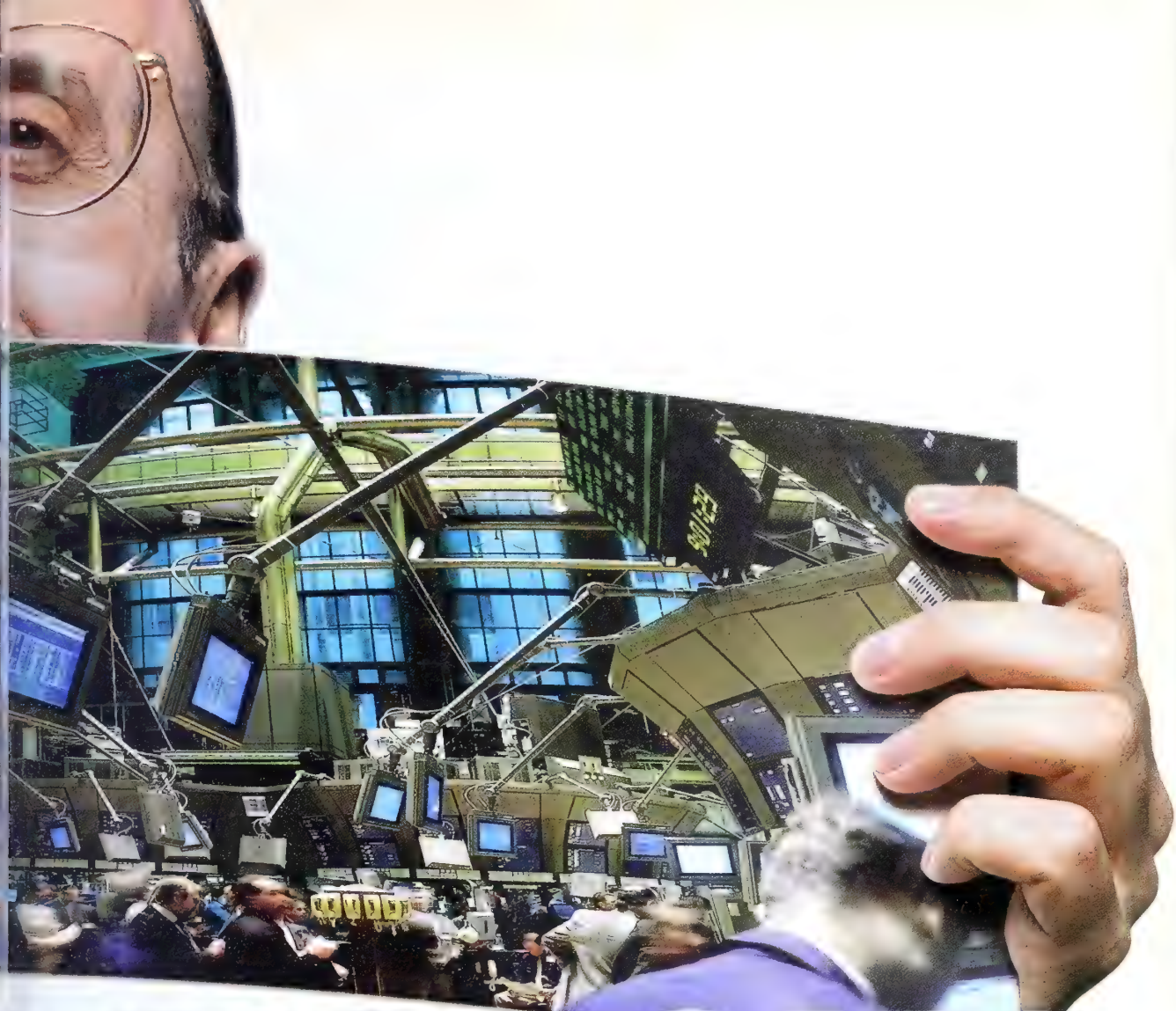
The luncheon room of the New York Stock Exchange is packed with the players and friends of the John F. Kennedy Knights high school football team. At a podium, Richard A. Grasso, chairman of the NYSE, is recounting a story. "Someone once asked me where my family's wealth came from," he tells the crowd of inner-city students, who had no place to hold their awards dinner before the NYSE donated its space. "I said: 'Oil, gas, and rubber.' I grew up in Queens. My relatives ran an Exxon station near LaGuardia Airport."

Thirty years ago, Grasso walked through the doors of one of the most insular and tradition-bound organizations in all of

How Chairman Dick Grasso is transforming the New York Stock Exchange

finance. The 22-year-old Grasso, who left New York City's Pace University a year before graduating, had no family connections or pedigree to help launch his career. Today, Grasso, 50, the first chairman to rise from the NYSE staff, was able to gain the top spot at the citadel of capitalism in June, 1995, in a remarkable accomplishment. More than just a personal victory, however, it signifies a new era at the exchange, an era in which the NYSE's efforts to recreate itself are paying off as it moves aggressively into new markets and counters a host of competitive challenges.

It's 11 Wall Street, not NASDAQ, London, or Tokyo, where many of the world's leading companies want their stock



BIG BOARD

ed. Of course, the NYSE's fortunes and those of other U.S. exchanges are being buoyed by the long bull market. But under Grasso, not only is the NYSE turning the tide and regaining precious market share in the trading of NYSE-listed stocks, it is rapidly increasing its roster of foreign companies and is attracting a record number of NASDAQ transfers, including high-profile technology companies such as Gateway 2000, America Online, Bay Networks, and Iomega—and is reverting the ticker symbol “M” in the hopes of one day snagging Microsoft. Grasso's ambitions don't stop there: The NYSE is also in hot pursuit of initial public offerings, where NASDAQ has long reigned supreme.

DOUBLED RIVAL. Scandals and regulatory problems in the NASDAQ stock market in recent years have thrown the NYSE's reputation for integrity and strong regulation into stark relief. The NYSE has been under constant competitive attack for the last 20 years, and there was certainly the threat that NASDAQ

would completely subsume their own role as the trading market of choice,” says Samuel L. Hayes III, a professor of investment banking at Harvard business school. “But I personally think NASDAQ has blown it.” Events at NASDAQ have “brought into question the integrity of that marketplace, and I don't think there's been anything comparable to that in the NYSE.” And while Tokyo and London have enjoyed periods in the last 15 years when their stature as financial centers was rising at the expense of New York, the NYSE is now benefiting from “the swing in the balance of power toward New York as the most important financial center,” says Hayes. “The NYSE is still seen by foreign companies as the prestigious market in the world to be listed on.”

Clearly, the NYSE is enjoying newfound momentum. The

Finance

GATES BAIT The exchange is reserving the ticker symbol

technology programs stressed by former NYSE chairman John J. Phelan, Jr. in the 1980s set a foundation that has enabled the NYSE to become more highly automated and cost-efficient than ever before. But whether NASDAQ has really blown it is debatable. In a way, a fresh battle is only beginning. NASDAQ remains a smart, aggressive, well-funded competitor. Its parent, the National Association of Securities Dealers, or NASD, has strong new leadership in Frank G. Zarb, a well-connected businessman with a solid history of turning around troubled organizations.

Finance

"It would be a great mistake to sell short the competitiveness of NASDAQ in the future," says William C. Freund of Pace University's Graduate School of Business and a former economist at the NYSE. "They're going to be reorganized and aggressive. In some ways they'll move more toward an auction-market setting, toward the NYSE model." As with the NYSE, NASDAQ's volume has mushroomed, and NASDAQ is also attracting record numbers of companies, though most are much smaller.

In the war between the exchanges, the winner will be the trading system that offers the greatest efficiency, the best service, and the most liquidity—at the lowest price. But there are other winners: The companies that will get fairer and more open markets for the trading of their stocks and the investors, both big and small, who will get the most for their investment dollars.

While the main battle is between the NYSE and NASDAQ, the two markets must also contend with a new breed of competitors massing on the sidelines. Such alternative trading systems, which include established electronic communication networks (ECNS) such as Instinet Corp., as well as the newer Bloomberg Tradebook, allow institutions to trade among themselves and avoid any middleman. The computerized systems are becoming more popular with powerful institutional traders, who view them as a low-cost alternative. The Securities & Exchange Commission recently asked for comments on how regulation needs to evolve along with these new ventures. It noted that "alternative trading systems handle almost 20% of the orders in over-the-counter stocks and almost 4% of orders in securities listed on the NYSE." That's up from 13% in OTC stocks and 1.4% in NYSE-listed stocks in 1991. ECN volume is getting a boost from new SEC rules. Among other things, the rules require some customer orders to be displayed to a broader audience. NASDAQ and some regional exchanges are exploring links with the ECNS, which could pump up their market share.

Meanwhile, business is booming on the NYSE. Membership prices are rocketing. Memberships, called seats, allow firms to trade on the floor of the NYSE. Seat prices hit an all-time high in 1996, when one sold

for \$1.45 million, up 38% from the high price in 1995. The latest public sale was for \$1.35 million. No wonder: The bull market has sent volume to a daily average topping 500 million shares, handled without a glitch by the NYSE's trading system, up from an average of 202 million in 1992. In 1996, the NYSE had net income of \$74.4 million on revenues of \$561.5 million, with more than 40% of revenues coming from listing fees, and the rest from fees including those for trading, market data, and use of facilities and equipment. That compares with net income of \$56.7 million on revenues of \$500.8 million in 1995.

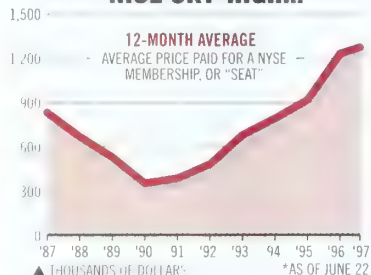
Grasso's NYSE is also regaining market share. In 1996, it wrested back some of the share it lost in the late 1980s and early 1990s when its portion of the volume of transactions of NYSE-listed stocks slid from 86.2% in 1988 to 81.7% in 1992. Now, the NYSE's market share is back up to 83% and has inched up in three of the past four years. More significant is its gain in the distribution of trades. In 1996, the NYSE got

73.2% of the total number of trades in NYSE-listed stocks made on U.S. exchanges, up from 70.2% the year before and up from a low of 65.2% in 1992.

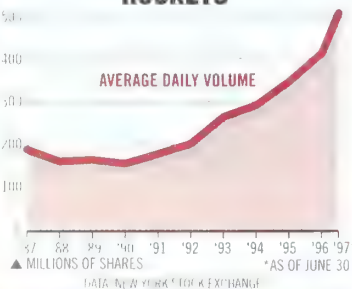
Crucial to the NYSE's future growth is progress internationally. In 1997, one out of every four new listings is a foreign company, and such listings have almost tripled in the past five years, to 320. Grasso hopes to increase that to between 500 and 600 non-U.S. companies by 2000. The NYSE calculates that the total market cap for international companies eligible to list on the NYSE is \$8.4 trillion. The NYSE has joined other U.S. exchanges in moving to allow price quotes in sixteenths, rather than eighths, and Grasso recently announced that the NYSE will be able to quote prices in decimals, rather than fractions, perhaps as soon as April 1998. That brings it in line with the world stock markets and fits nicely with the NYSE's overarching goal to be the first "true global" stock exchange. "We have the opportunity to redefine this franchise for a very long period of time," says Grasso. "That gives everything we do."

To lead the international charge, Grasso recruited European investment banker Georges L. Ugeux in 1996. He also expanded the NYSE's network of International Advisory Committees, adding a Latin America Committee headed by Carlos Salazar, the head of Teléfonos de México, and broadened the Japanese Committee into the Asia-Pacific Advisory Committee to include the entrepreneur-rich Pacific Basin. Grasso himself travels extensively abroad. **OUT OF AFRICA.** The NYSE's international roster is led by companies from Britain, Canada, Chile, and Mexico. Privatizations such as the IPO of Germany's Deutsche Telekom in 1996 have been a great boon

NYSE SEAT PRICES RISE SKY-HIGH...



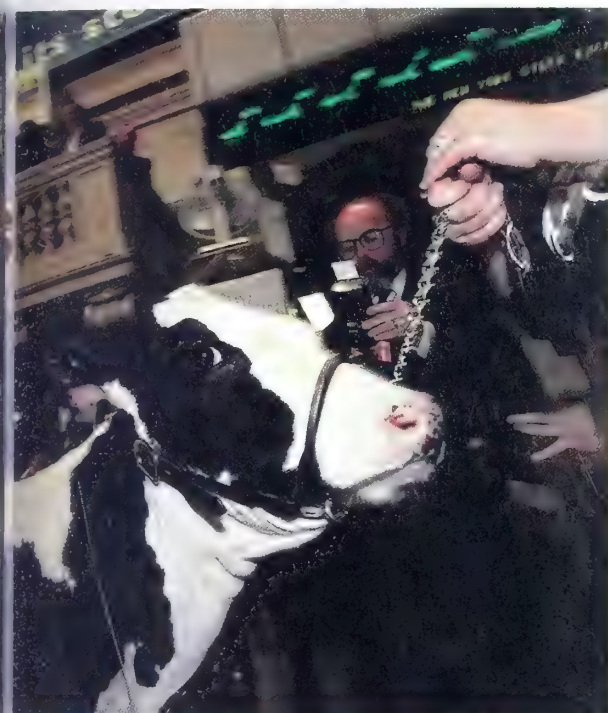
...AS VOLUME ROCKETS



LITTLE POINTS COUNT

Grasso's move to decimal pricing was unexpected—but practical

... of someday luring Microsoft into the fold



STEINS AND FLAT SCREENS

The NYSE is focusing on high-tech recruits—Gateway 2000 might mascot Arianna to the floor when it was listed—while promoting its own \$1.2 billion investment in technology

NYSE. But the Big Board is looking to all corners of the globe for new listings. "If I were just taking India, Brazil, China, those three probably represent over the next five years a huge reservoir," says Ugeux. Last year, the NYSE listed its first Russian company, Vimpel-Communications, and its first African company, Ashanti Goldfields Co.

NASDAQ is also looking abroad for growth. "International will be a key battleground for us," notes Zarb. "They're formidable and we are, too. We have to be a little better because we don't have the years of history and tradition and image." With the NYSE and NASDAQ's global ambitions are hampered by slow progress in developing international accounting standards acceptable to both the SEC and other countries. To be a truly global exchange, the NYSE will need to offer to trade global products and trade so-called ordinary shares—foreign shares listed directly on the NYSE—in addition to the usual American Depositary Receipts. The NYSE is building capabilities to trade non-U.S. shares in ordinary form, in dollars or possibly also in one or more other currencies, says Robert Britz, the NYSE's head of operations and technology.

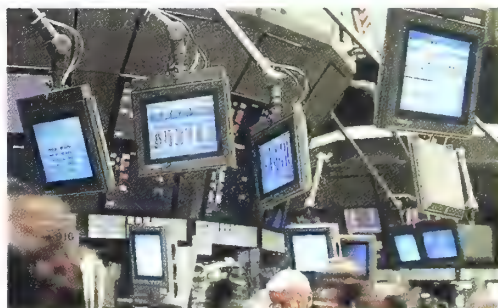
SPRING IN. In their forays overseas, NASDAQ and the NYSE are talking up the virtues of their particular brand of trading. At the heart of the NYSE-NASDAQ clash has been the issue of which market has the better trading system. In the NYSE's highly-automated, but floor-based system, NYSE members called specialists must maintain an orderly market in the

trading of their assigned stocks, with one specialist for each stock. If a significant imbalance between supply and demand develops, the specialist must step in with his firm's capital to buy or sell stock and provide a "fair and orderly market." In the vast majority of cases, retail orders meet and are executed without the specialist stepping in.

To speed up the process, the NYSE has invested \$1.2 billion in technology during the past decade. "Technology is the saving grace," says the NYSE's president, William R. Johnston. "We're running this exchange with fewer people than ever before." Now, the NYSE features the world's largest commercial



installation of flat-screen, high-definition display panels and is working on a wireless communication system to make floor brokers more efficient. About 85% of all trades in NYSE-listed stocks, or 40% of the dollar volume of its trading, flow through the NYSE's automated order-handling system. The NYSE can process 2.3 billion shares a day, more than 4



times its average daily volume, and plans to be able to process 3 billion by the end of the summer. NASDAQ has sped up an overhaul and expansion of its network, which can process 1 billion shares a day. It plans to be able to process 2 billion by early 1998.

In the screen-based NASDAQ market, competing dealers, called market makers, have traditionally interacted electronically with just about every trade. A customer's broker sends her order to the market maker offering the best price. Market makers profit from the gap, or spread, between the price they pay to buy shares and the price they offer to sell those shares to another investor. To be sure, NYSE specialists, who get commissions, also profit from trading for their account, but with customer orders taking precedence over specialist trades, spreads have tended to be narrower on the NYSE.

NASDAQ's growth since its inception in 1971 has been phenomenal, but its fundamental system of trading has come under attack in recent years. It was the subject of a Justice Dept. review of whether NASDAQ dealers colluded to set stock prices. In August, 1996, the SEC censured the NASD for failing to halt widespread price-fixing on NASDAQ. The NASD agreed to pay at least \$100 million over five years to upgrade regulatory operations, and the regulatory effort is now separate from the operations of the NASDAQ stock market.

Now, the new order-handling rules instituted by the SEC are changing the trading landscape. The rules, which create a more level playing field for small investors, are being phased in on NASDAQ stocks and also apply to the NYSE. For the first 500 stocks phased in, a NASDAQ analysis found the average quoted spread shrinking by more than 30%. If spreads continue to narrow as more of NASDAQ's stocks come under the rules, companies that added wide spreads to their list of reasons to move to the NYSE may be less inclined to leave



TAKING A TOSS

Foreign privatizations and startups are prime prospects. Last year, Vimpel-Communications became the first Russian company to list

transferred to the NYSE in 1996, "there aren't that many companies left on AMEX that fit our listing standards," says L. Paige Thompson, the NYSE's vice-president for domestic listings. While the NYSE and NASDAQ are focused on many of the same companies, AMEX is adopting a new niche strategy as its equity business shrinks to an average of just 22 million shares a day. While continuing to focus on its successful options business, it is pursuing a novel strategy to build investment banking relationships to help draw a tier of smaller companies that could become less attractive to NASDAQ dealers under the new order handling rules. Amex is offering aggressive investor relations support programs to increase the companies' visibility.

Although Grasso won't say it, NASDAQ's travails with the

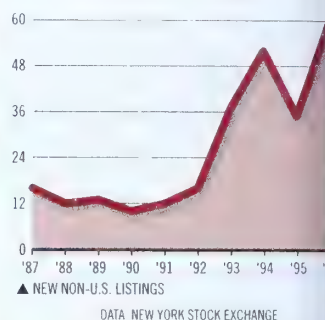
NASDAQ. But if market makers are loath to take the same level of risk for a now diminished reward, there may be less liquidity and the new rules could lead to greater swings in NASDAQ stock prices.

One competitor the NYSE doesn't worry about: the American Stock Exchange.

After 22 AMEX companies transferred to the NYSE in 1996, "there aren't that many companies left on AMEX that fit our listing standards," says L. Paige Thompson, the NYSE's vice-president for domestic listings. While the NYSE and NASDAQ are focused on many of the same companies, AMEX is adopting a new niche strategy as its equity business shrinks to an average of just 22 million shares a day. While continuing to focus on its successful options business, it is pursuing a novel strategy to build investment banking relationships to help draw a tier of smaller companies that could become less attractive to NASDAQ dealers under the new order handling rules. Amex is offering aggressive investor relations support programs to increase the companies' visibility.

Although Grasso won't say it, NASDAQ's travails with the

NEW FOREIGN LISTINGS HIT A RECORD



regulators have given the NYSE an edge in persuading companies to list over. In the U.S., the tech sector is the main battleground, and Grasso

isn't shy about coveting what he calls NASDAQ's "fearsome foursome": Microsoft, Intel, Cisco Systems, and Amgen. Explaining why the NYSE moved to cap the maximum listing fee at \$500,000 last year, Grasso notes that since listing fees are structured on shares outstanding, a company such as Intel Corp. might have had a listing fee of \$2 million or more.

To be where the action is, the NYSE opened a small office in Menlo Park, Calif., in the heart of Silicon Valley. The board's attempt to woo companies from NASDAQ has "escalated dramatically," says Sanford R. Robertson, chairman of Robertson, Stephens & Co. "I'm surprised they haven't done it sooner." Says Daniel H. Case III, president and chief executive officer of Hambrecht & Quist, the high-tech investment-banking firm, which listed on the NYSE last year: "They spent more money and are working aggressively for it." NASDAQ is beefing up its Menlo Park office and now has 18 people there. **NYSE PERKS.** Both NASDAQ and the NYSE provide some form of advertising support to attract and retain companies. "We'll promote a new listing so a company can say to themselves that the NYSE includes us in their advertising or seminar program, and we will, in essence, bring down the cost of listing," says Grasso. "It's an investment we're making in the merchandising of an important listing event." The NYSE throws in perks such as access to its boardroom for company functions and analyst meetings.

NASDAQ's president, Alfred R. Berkeley III, doesn't shy away from saying how much the NYSE's wooing of its pre-

THE UNLIKELY LIFER FROM QUEENS

About a year ago, Richard A. Grasso, chairman of the New York Stock Exchange, was bobbing and weaving in a boxing ring. As part of a charity bout attended by the Wall Street community, the short, slight 50-year-old sparred with Roy Jones Jr., the International Boxing Federation super middleweight champion at the time. The two put on a great show, helping to raise \$1.5 million for the U. S. Olympic Committee.

Grasso isn't your typical NYSE chairman. He's the first "homegrown" one, having joined the NYSE's listing department in 1968. Grasso didn't plan on be-

coming a lifer: "I was going to use it as a platform to go somewhere else," he says. "I wanted to be a trader." Instead, Grasso, who is described as a shrewd behind-the-scenes operator with superb people skills, rapidly rose through the ranks and was mentioned as a candidate for the chairmanship seven years ago, when he was president. The board ultimately appointed William H. Donaldson, but one of his mandates was to prepare Grasso for the top slot, which he got in June, 1995.

Grasso grew up a subway ride away from the exchange in the lower middle-class neighborhood of Elmhurst,

Queens. He's loyal to his roots; recently, he still owned the apartment in the five-story walkup where he was raised, though it had sat empty for years. It was in Elmhurst that he bought his first stock, at age 14, a \$1,000 saved up from a job in a grocery store. The stock was an airline stock. "experiential investing: I used to read *LaGuardia* and watch the plane take off." Today, he, his wife, son, and two daughters live in exclusive Larchmont, N. Y., and also have a home in the Hamptons on Long Island.

Charitable and civic activities have taken up a good chunk of Grasso's time.

panies irks him: "We'd like to be let alone," he says. If not, we're going to be their worst enemy, their worst nightmare." Berkeley says that except when listing issues come up, he doesn't spend much time thinking about the NYSE. Instead, "we think about a new pricing curve where we have very significant competitors that are emerging on the Internet," he says.

Each company that left NASDAQ for the NYSE cite a wide range of reasons for switching. "We thought it would become more appropriate as we became more established," says Scott Murray, Learning Co.'s CFO. Murray, along with Iomega Corp.'s treasurer Robert J. Simmons, also cite high levels of customer service from their specialist. "You end up with one market more familiar with your stock because they are the only one," says Murray. "You have better visibility on who the buyers and sellers are."

The NYSE's prestige internationally is also a selling point. For America Online CEO Stephen M. Case, moving to the NYSE was part of "improving our global profile." The NYSE has the prestige and global reach AOL wanted as it moves into new markets in Europe and Asia. Also, "we felt an international market with a specialist would mean lower spreads. And that has happened," says Case. According to AOL's investor relations, on NASDAQ only 38% of trades have a spread of one-eighth or less, compared to 60% on the NYSE.

Despite these high-profile defections, NASDAQ still boasts many of the leading technology companies. Among them are companies that have a strong sense of loyalty to a market that took them on when, say, the NYSE would not. NASDAQ's system of multiple market makers for each stock provides liquidity to smaller companies that don't yet have a following among analysts and need multiple dealers to generate more interest in their stock. And when it comes to listing fees, the price is right on NASDAQ, where listing fees are far lower than on the NYSE. NASDAQ is also the master of an art that the NYSE is just now getting better at: self-promotion and marketing. The NYSE doubled its entire advertising budget from \$7 million to \$14 million for 1997, but that pales next to the \$20 million that NASDAQ has to spend on TV advertising alone.

Meanwhile, NASDAQ disputes the notion of a nascent exodus of companies to the NYSE. A record 96 U.S. and non-U.S. NASDAQ companies defected to the NYSE in 1996, up from 62 in 1995 and 45 in 1994, but "there wasn't a break in the dam at all," says John Wall, NASDAQ's executive vice-president for market services. "We lost some good-size companies, such as Bay Networks, America Online, and St. Jude Medical, but we lost them all for specific reasons," says Wall. The NYSE, he notes, was Bay Network's largest customer.

As for the leading member of the "fearsome foursome," Microsoft's chief financial officer, Michael W. Brown, has just been appointed chairman of NASDAQ's board of directors. Intel's Treasurer, Arvind Sodhani, also on NASDAQ's board,

Finance

IN THE TRENCHES

The NYSE's quest for brand identity includes being an accommodating host to broadcasts from the floor



states: "We're very well served by NASDAQ." Yes, he says, the NYSE has made a "fairly determined effort" to attract Intel, but "there's no reason to move." As for tech firms such as Bay Networks and Iomega that made the move, Sodhani says that "a lot of those are younger firms, and they may have had their own reasons to want to do it."

Wall complains that the competition is skewed because of the NYSE's Rule 500. That requires that NYSE companies get a supermajority of shareholders voting approval if a company wants to delist. The NYSE says the issue is a red herring, since companies don't want to leave. Wall says the issue is not a red herring and that he has the letters from NYSE companies to prove it.

The rule helped the exchange land Concert PLC, the proposed entity that would come out of the planned merger of MCI Communications, NASDAQ's fifth-largest company, and British Telecommunications, an NYSE company. Both NASDAQ and the



particularly involved in children's charities and police organizations. "I have the ultimate respect for what [the police] do," he says. "The NYSE is blessed with a level of commitment from the New York City police force that is extraordinary." Grasso worked closely with former Police Commissioner William J. Bratton, sponsoring breakfasts at the NYSE for the NYPD's top brass to gain management insights from the likes of Jack Welch of General Electric and Harvey Golub of American Express. "Dick saw it as a way to support the city," says Bratton.

One criticism of Grasso that surfaces is that he is controlling. "Dissent is not

tolerated," says one former employee. Grasso finds such assertions reflective of a much earlier time at the NYSE. "When we have meetings, I think we're a better company by the dissent," he says. Critics also wonder whether Grasso has a broad enough vision, having worked only for the NYSE. "They've been wondering that forever," says Grasso, with a smile. "I guess they'll only know after I'm gone."

For all his intensity, Grasso is not above poking fun at himself. At a dinner with 30 or so members of the trading-floor community in March, Grasso, along with the rest of the table, eyed the towering pile of salad placed in front of him. "It's embarrassing to be as tall as your meal," he deadpanned.

By Suzanne Woolley in New York

WELCOME TO THE FLOOR: Roy Jones Jr. takes a dive facing Grasso



NYSE wanted Concert, and on Apr. 14 MCI announced that Concert would join the NYSE. Since BT's shares are on the NYSE and will be renamed Concert, moving BT's shares to NASDAQ would run up against Rule 500. In a press release, MCI chief executive Bert C. Roberts Jr. said that "securing the approval would have been inappropriate at a time when shareholder focus should be on the merits and opportunities presented by the merger." Roberts griped to SEC chairman Arthur Levitt Jr., who asked the NYSE to review the rule. The NYSE is reevaluating the rule and expects to have a decision by year's end.

Not only does the NYSE want NASDAQ's stars of today, it doesn't want to miss another Intel-in-the-making. Until 1983, only three IPOs had been launched on the NYSE. Since then, over 700 companies, excluding closed-end funds, have gone public on the NYSE. According to Securities Data Co., the NYSE had 117 IPOs in 1996, with proceeds of \$23.7 billion, up from 74 IPOs with proceeds of \$13.7 billion in 1995. NASDAQ had 730 IPOs in 1996 with proceeds of \$25.4 billion.

Finance

The NYSE will soon launch an ad campaign focusing on its IPOs.

Quality control will be a key issue for the exchange when pursuing more entrepreneurial companies. "Grasso's problem is to get more listings while, at the same time, maintaining the listing requirements for those companies coming on board," notes Perrin Long, an independent analyst of the securities industry. The NYSE has modified its listing standards in recent years to allow companies to qualify based on cash flow. That attracted a number of cable and broadcasting companies. Previously, companies had to meet minimum earnings levels and have three consecutive years of profitability. And in mid-1996, the exchange altered what it calls the "North American standard" so that companies could aggregate holdings in Mexico and Canada with their U.S. operations in order to qualify for a listing.

Increasingly, the competition between the NYSE and NASDAQ is evolving into a battle of the brands. "Every day, we wage what we call a cornflakes war of brand preference," says Grasso. The NYSE has greatly increased its visibility by expanding its broadcast-center operations and allowing more TV stations to set up booths above the exchange floor or to broadcast from the floor itself. The NYSE also made real-time stock prices available to TV stations such as CNBC, CNNFN, and Grupo Televisa in late 1996. About 100 live broadcasts go



NASDAQ OR NASA?

Not to be outdone in technology, to say nothing of stage props, NASD's Zarb and Berkeley have launched their own high-tech "market site" in New York

out from the NYSE every day, compared with fewer than 30 in 1995. One of the fastest growing items in the NYSE revenue stream is from the sale of market data. That produced \$4 million in revenue in 1996, a 14% increase from 1995.

NASDAQ is countering with its own broadcast site in Manhattan—a room dominated by 100 video monitors. Much like the NYSE's trading floor provides photo opportunities for newly listed companies, NASDAQ's site is a slick showplace to impress prospective or new NASDAQ companies, serve as a backdrop for broadcasts, or be used for analyst meetings.

SCATTERED BATTLES. As the NYSE dukes it out with NASDAQ for new listings, it is also waging a fierce fight to have more of the trades in those stocks executed on the NYSE, rather than on one of the regional exchanges. It remains to be seen whether quoting prices in sixteenths of a dollar, instead of eighths, a step toward decimalization, will affect the war for market share. "We think our volume will go up, and that our market share will increase dramatically," says Grasso. "It will impose significant competitive pressures on alternative markets." If it makes it tougher to pay for order flow, he says, referring to the sale of orders to firms that pay a few cents per share for orders routed their way. If the gap between the bid and offer on a stock shrinks from the minimum 12.5¢ gap that has been the standard, that practice will become less lucrative—and, Grasso hopes, fewer orders will be drawn away from the NYSE.

As technology breaks down the barriers to entry into securities trading, the pace of change at the Big Board will have to increase. The competitive forces gathering to upend away at its franchise are huge. Yet the NYSE has been combating such pressures for decades and has managed to flourish. Richard Grasso is quite aware of the challenges facing his NYSE—and will fight like hell to maintain its momentum. As the battles continue, the real victors will be investors who get lower trading costs and better service.

By Suzanne Woolley in New York, with bureau reports

GENE G. MARCIAL

MID-CAPS TO TICK A FEATHER IN

Who's feeling acrophobic in this soaring market? Not Larry Keblusek, U.S. Chief Investment Officer Citibank Global Asset Management. In spite of the Dow's speedy climb over 8000, good stock values abound," says Keblusek, who oversees assets of \$8 billion—mostly invested in equities, a big chunk in high-flying big-cap stocks. But Keblusek's new focus is on mid-caps.

Keblusek says the best values are in stocks with market capitalizations between \$1 billion and \$10 billion. "We look for companies with a record of solid growth—and are finding a lot of undervalued gems," he says.

Four picks: ■ Consolidated Stores (CNS), a retailer of closeout merchandise.

■ Leggett & Platt (LEG), a maker ofosaic but essential products such as furniture components and bed frames.

■ UCAR International (UCR), a producer of the graphite electrodes that nimills use in making steel.

■ Zions Bancorporation (ZION), which provides banking and insurance services in the Mountain States.

Consolidated Stores has been hot, coming from 26 a share in January to 38½ on July 22. The company buys excess merchandise—often discontinued lines—at a deep discount and unloads it at its 1,840 outlets—Odd Lots, g Lots, and Kay-Bee Toy & Hobby ops. With its vast warehouses, Consolidated can deal in huge volumes.

Leggett & Platt is also on a roll, rising from 31 in January to 43 on July 22. Citibank's Rich Goldman says the street expects Leggett to earn \$2.14 a share this year and \$2.49 in 1998. But he says: "We think it will earn more—\$2.00 and \$2.60, respectively."

UCAR's stock, now at 44, has been



KEBLUSEK: Most of his \$28 billion in equities

held back by a Justice Dept. probe into allegations of price-fixing among makers of graphite electrodes. But Keblusek believes there is no collusion. He views the current stall as a buying opportunity. He thinks UCAR will beat Street estimates of \$3.45 a share for 1997 and \$4.05 for 1998. His estimates: \$3.60 and \$4.20, respectively.

Shares of Zions have vaulted from 28 in late January to 35 on July 22. "Zions is an efficient, tightly disciplined, and highly profitable bank," notes Keblusek. It has a return on equity of 21.5%, vs. a 15.5% average for the top 100 banks. He expects Zions to earn \$2 a share this year and \$2.25 in 1998, vs. the Street's \$1.90 and \$2.

A NEW STUNT AT CIRCUS CIRCUS?

A thunderbolt has struck Circus Circus Enterprises (CIR): Shares have tumbled from 36 in February to 23 on July 22. One reason: Analysts have cut their 1997 earnings estimates. A general slowdown in Las Vegas plus a glut of new hotels, analysts say, have kept many rooms empty at Circus Circus.

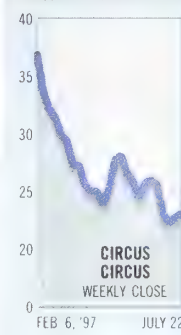
Enter several hedge-fund managers, including some heavy hitters who asked not to be identified. They've been buying Circus since it hit a low of 21 on July 9—two days after gambling analysts downgraded the stock.

Why are hedge funds snapping up shares? They wouldn't say, but some money managers suspect Hilton Hotels is eyeing Circus Circus for a takeover.

Circus Circus has nine hotel-casinos in Nevada, including three on the Las Vegas strip. It also runs riverboat casinos in Tunica, Miss., and Elgin, Ill.

Hilton hasn't officially withdrawn its hostile bid for ITT, which has decided to split into three companies to thwart Hilton's takeover plot. But one investment banker says Hilton plans to switch its attention to Circus, which is worth 30 to 32 in a buyout. "Management wouldn't be unhappy with such an offer," says the banker, who believes Hilton will

DOWN AND OUT IN LAS VEGAS



SOURCE: BLOOMBERG FINANCIAL MARKETS

make its move soon, while Circus stock is in a funk. Chuck Di Rocco, editor of *Gaming Today*, says management "would sell if a reasonable offer came along." Hilton spokeswoman Kathy Shepard declined comment.

SCUFFED-UP GUCCI MAY GET A SHINE

With Gucci Group (GUC) close to its 1997 low of 61 a share, recent investors are disappointed. CEO Domenico de Sole shares their feeling and says the stock was beaten down unjustly.

What's he going to do about it? "Everything," he says. The company will buy back shares (it has \$200 million in cash, notes de Sole); enlarge stores in big cities, including Tokyo, Milan, and Paris; add 25 new stores; and expand new products, such as more ready-to-wear apparel and fashion jewelry.

"We're obsessed with keeping intact the quality of our world-famous brand," says de Sole, "while we expand our reach in Europe and Asia and bolster our strength in the U.S." Gucci sales are expected to hit \$1.1 billion this year and \$1.3 billion next.

"We will move fast," vows de



CEO DE SOLE: "Obsessed" with preserving quality

Sole, just as he did three years ago when Gucci was battling bankruptcy and liquidation. Bahrain's Investcorp International bought the company from the Gucci family and brought in de Sole. Investcorp took the company public in October, 1995, at 22 a share and finally sold all its shares in a secondary offering in March, 1996, at 48.

In spite of the stock's recent poor showing, analysts remain bullish: "Gucci is by far the cheapest growth stock, not only in luxury goods but in the whole European retail sector," says Claire Kent of Morgan Stanley, Dean Witter Discover, in London. She expects Gucci to earn \$3.38 a share in the year ending Jan. 30, 1998, and \$4.05 in 1999, vs. 1997's \$2.76. Her target for the stock: 90.

Back in July, 1995, no computer maker was flying higher than Silicon Graphics Inc. Its dazzling three-dimensional graphics computers had a starring role animating the fearsome dinosaurs in *Jurassic Park*. Nintendo was using the same technology to give the Mario Brothers a face-lift and to design a new generation of arcade-like game machines. And sales were soaring. For the fiscal year ended that June 30, revenue skyrocketed 45%, to \$2.2 billion—far outpacing all rivals. To top it off, CEO Edward R. McCracken was a White House regular, hobnobbing with Bill Clinton and Al Gore. SGI's sexy image prompted a Wall Street analyst to label it "the new Apple."

Sadly for SGI, that may prove all too true. Now, like Apple Computer Inc., the Mountain View (Calif.) company is a stark anomaly in booming Silicon Valley. While rivals such as Sun Microsystems Inc. ride the Internet wave and even IBM enjoys a comeback, SGI has been mostly an onlooker at the tech party. After racking up losses of \$35 million in the first half of this year, the company managed to carve out a profit for the 1997 fiscal year ended in June, thanks to a strong fourth quarter. Still, the stock, even after bouncing up from its low of 12% last April to 18% on July 23, is at less than half of its value 24

months ago. Dubbed "the gee-whiz company" by **BUSINESS WEEK**

Cover Story

three years ago, SGI is scrambling to stay off technology's long list of has-beens. Concedes McCracken: "If we can't produce good quarters, we're not going to have a future."

Gee whiz! What happened? A classic Silicon Valley tragedy, that's what. Like so many highfliers, SGI rocketed to fame and fast fortune on the wings of a snazzy new technology—in this case, powerful computer workstations and servers with 3-D graphics so realistic that they became the computer of choice for Hollywood filmmakers, engineers, and scientists.

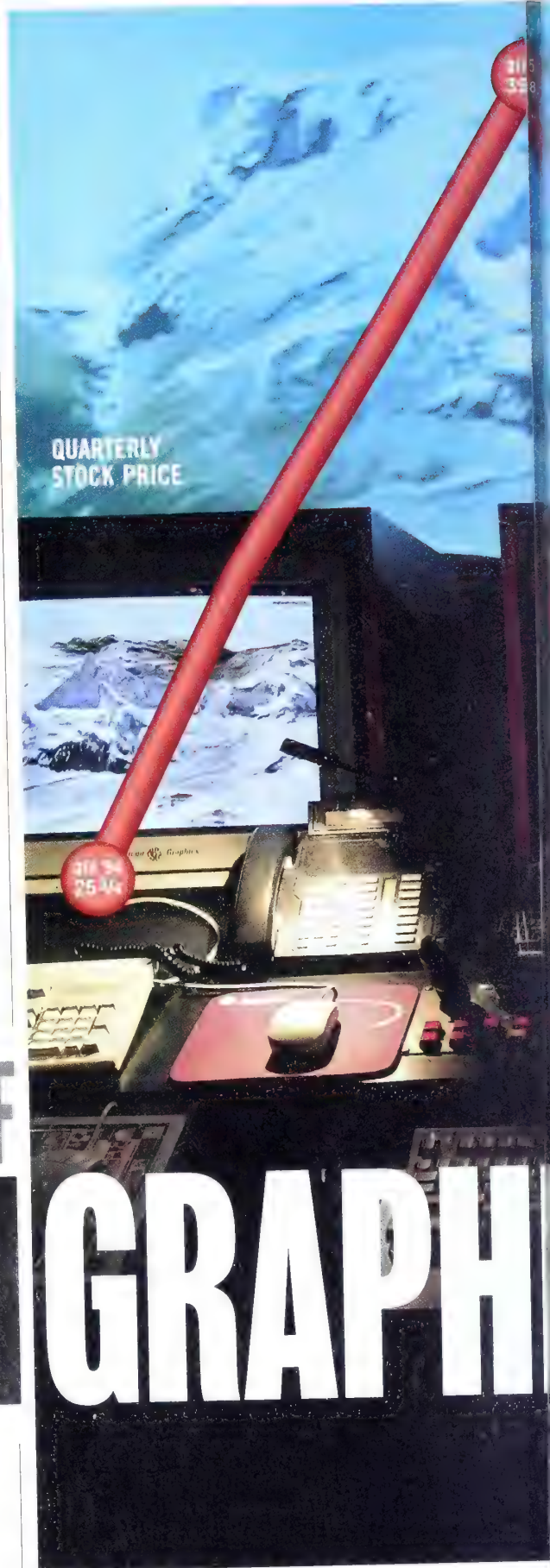
But SGI executives got drunk on their own success. They dashed into glitzy new markets such as supercomputers, interactive cable TV, and digital film studios while barely tending to their bread-and-butter computer business, which produced machines late, incomplete, or dead on arrival. And basics such as marketing, inventory management, and quality control were far too mundane for the company that whipped up computer-animated raptors and a *Tyrannosaurus rex*.

Indeed, interviews with more than 85 people inside and

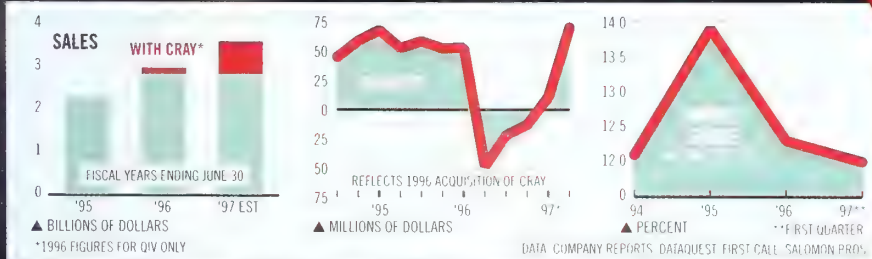
THE SAD SAGA OF SILICON

GRAPH

What went wrong at the company that once made everybody say: "Gee whiz"



**CEO McCracken:
THE BOARD
IS IMPATIENT**



DATA: BLOOMBERG FINANCIAL MARKETS

SGI'S RISE AND DECLINE

JUNE 7, 1993 Time Warner Cable chooses Silicon Graphics (SGI) to develop technologies for its high-profile interactive television trial in Orlando.

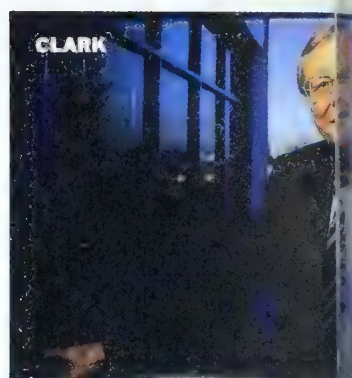
JULY 27 SGI reports its first billion-dollar sales year.



AUG. 23 Nintendo agrees to use SGI technology in its future video-game player.



JAN. 6, 1994 CEO Ed McCracken is named co-chair of Clinton's National Information Infrastructure Advisory Council, leaving COO Tom Jermoluk to run daily operations.



JAN. 27 Co-founder Jim Clark to start Mosaic Communication, renamed Netscape.

MAY At an executive offsite in Monterey, Calif., McCracken challenges company to increase annual sales growth from 36% to 50%.

DEC. 14 Eight months later, The Warner finally launches a downsized interactive-TV trial in Orlando.

outside SGI reveal a company that lost touch with basic business practices. Until recent months, poor planning often led to the company shipping products that generated a staggering 80% of its quarterly revenue in the last month of the quarter—leaving no margin for error. And like Apple, SGI gorged on fat profit margins, ignoring the lean, savagely aggressive personal-computer makers that were churning out ever more powerful machines and starting to steal SGI's customers. The company's share of the \$12.7 billion workstation market has slipped to 12%

in the first quarter of 1997, vs. 14% in 1995.

Perhaps most stunning are the missed

Cover Story

opportunities. In early 1995, SGI was a front-runner on the Net, with its servers running such Web sites as HotWired and Virtual Vineyards. But by sticking too long with ill-fated interactive TV, it lost its Internet standing. Now, SGI is a Web also-ran, forced to watch as SGI co-founder James H. Clark cashes in with his Netscape Communications Corp. Just last year, SGI blew yet another opportunity: When its stock was one-third higher than today's price, say insiders, McCracken didn't pursue initial feelers from acquisition-minded Sun Microsystems, which stole SGI's panache and profits by turning its own interactive-TV efforts into the popular Net software Java.

STERN WARNING. Now, McCracken is on the hot seat. At a board meeting last January, directors urged him to restore SGI's momentum. They didn't set a deadline, but insiders say the board is growing impatient with the stream of quarterly disappointments. "The buck has to stop with Ed," says board member C. Richard Kramlich, managing general partner at venture capitalist New Enterprise Associates. "If Ed's not qualified to lead the company, we'll know very soon."

Widely respected for helping SGI become one of the world's leading computer makers, McCracken took his eye off the ball during his 1994 Washington sojourns. Then early last year, after his 11-year marriage began to sour, he began a public relationship with a young SGI employee. Their displays of affection shocked some workers. Says a former colleague: "When people are walking around in a funk, and Ed is walking around with stars in his eyes, they say, 'What's going on here?'"

Such distractions have not been limited to McCracken. For-

mer President and Chief Operating Officer Thomas A. Jermoluk, once the charismatic leader who guided SGI through its go-go days, came under criticism for his freewheeling, work-hard, play-hard style.

Especially the play-hard part. While Jermoluk was the charismatic startup leader who even manned the manufacturing lines during crunch times, he was not one for structured, corporate business processes, or even a corporate demerol. Jermoluk helped set the frat-house tone at SGI early. Jermoluk, for example, admits he and several colleagues once mooned SGI employees at one of the company's annual lip-synch contests. And on one occasion, says a former manager, Jermoluk was drinking and threw up at a poolside sales meeting in Hawaii.

For Jermoluk's part, he says he does not recall the incident. "Am I guilty of getting drunk a few times?" he asks. "Sure. Probably inappropriately at times? Yeah. Did I party hard? Sure." But he also adds: "Was I leading a wild life? No. I was working too hard, man." Even Jermoluk's critics say he never impaired his job performance, but such overindulgence at the company's No. 2 rattled some employees' confidence. "People aren't used to seeing the president get drunk," says a former executive.

Nor are they accustomed to seeing SGI flounder. What was to be sure, SGI's computers still do things no others can match. Its most powerful graphics workstations, accounting for nearly a third of its sales, are still the front-runners for the most demanding 3-D animation. And its technical servers and supercomputers, which generate 35% of revenues, are tops in serious number-crunching.

Now, with long-delayed products finally starting to ship in volume, SGI may be on the road to recovery. In the last quarter, reported on July 24, SGI showed decent improvement for the first time in nearly two years. By making progress on longstanding execution problems and finally shipping a backlog of orders for its bread-and-butter computers, SGI reversed a slide. With the stock far below its peak, analysts say it could boost the share price in the next few months.

What's more, McCracken thinks new business procedures now being put in place, such as streamlining the time from quoting an order all the way through to shipping it, will yield even bigger dividends in coming quarters. Longer-term

1995
software
as Alias
and
t Tech-
for \$500
bid to



JULY 10 SGI introduces new Indigo workstations, hoping they will generate \$1 billion in sales this fiscal year.

SGI reports 45% growth in fiscal 1995, ended June 30, to on, and a 58% jump in profits, million—the 12th strong quar-

OCT. 19 Blaming a recent sales-force reorganization, SGI reports first-fiscal-quarter revenues lower than expected—\$595 million vs. expected \$650 million.

NOVEMBER Sun steals some of SGI's Hollywood thunder by announcing that Pixar Animation Studios used 117 Sun computers to help produce graphics for the film *Toy Story*.



JAN. 17, 1996 SGI reveals that shortages of graphics chips from Toshiba caused revenues to rise only 22%, to \$672 million, under original forecasts of \$760 million.



JANUARY Sun makes overture to buy SGI, but initial feelers go nowhere.

FEB. 26 SGI buys Cray Research for \$767 million.



, the Internet will spur more demand for powerful servers SGI's to serve as commercial "network hubs."

Despite the latest quarter's improvement, SGI's long-term is in doubt. McCracken's big dilemma: He either ks to SGI's high-performance niche and gives up the ce for big spurts, or he radically changes SGI's business el to compete with commercial computer makers like and the PC makers. But so far, SGI has produced no con- ing answer to the PC threat. And Sun, IBM, Hewlett- kard, and others have a big, perhaps unbeatable, head- t on selling to Corporate America. Co-founder Clark,) resigned in a huff three years ago, offers a bleak as- ment: "I think the company is headed for a potential dis- er. SGI has squandered its advantage. Now, PC has won. Game over."

ING STAR. McCracken and his team couldn't agree more. Overall, McCracken says SGI can w 15% to 20% a year—not bad, but a big edown from the years of 36% and 45%. That's 7 SGI execs have spent the past nine months k with high-powered consultants such as necticut marketing wiz Jack Trout to craft a vi- for SGI's future. "Our marketing has sucked for years," says McCracken. Yet beyond a me-too is on large servers to run networks and a vow listen more closely to customers, McCracken's on is fuzzy.

How did SGI get to this sorry place? The roots the company's ailments stretch back more n three years, when business was humming, was the star of Silicon Valley, and high tech s a hit in Washington. On Jan. 6, 1994, McCracken—an in- spective former Hewlett-Packard Co. exec who likes to etice and teach meditation—was named co-chair of Clin- 's National Information Infrastructure Advisory Coun- Soon, he was deep into Washington politics, helping craft ernment policies on communications technologies. Just ew weeks later, Clark—frustrated with his repeated fail- to persuade McCracken and Jermoluk to come out with eper workstations—resigned to start the company that s soon to become Netscape. That left much of SGI's oper-

**AFTER
SEVEN
ROCKY
QUARTERS,
PROFITS
ARE UP**

ations to Jermoluk, 37, who was appointed president on Feb. 2, 1994.

T.J., as he is known, seemed up to the task. A crack engi- neer at HP and Bell Laboratories, the hard-charging Jermoluk had quickly worked his way up SGI's ladder after joining as an engineer in 1986. Blond and lanky, Jermoluk soon proved a magnetic leader, whipping the troops into a frenzy at the com- pany's frequent "all-hands" meetings. Says Pavan Nigam, for- mer director of SGI's interactive TV project with Time Warner Cable: "His macho, can-do, aggressive style got the whole company stomping its feet."

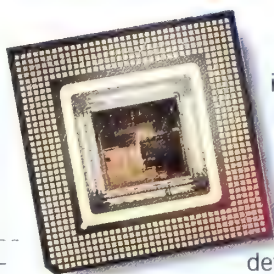
Good thing—because he and McCracken were about to up the ante. At a posh seaside resort in Monterey, Calif., in May, 1994, some two dozen top executives huddled to set plans for the next fiscal year, starting on July 1. After the first day of discussions, McCracken and Jermoluk made the case that they should seize the chance to build a large company while they still could. At the time, Sun was moving away from SGI's niche engineering stronghold to work- stations and servers for large corporate networks and IBM and Digital Equipment Corp. were strug- gling. Moreover, the Information Superhighway promised SGI fresh opportunities. "Ed said to think out of the box and figure out how to grow 50%," recalls former Vice-President Way Ting, founder and CEO of software startup Pietra Inc.

That set off feverish activity within SGI to reach that goal, which quickly led to burnout and worse: Key evangelist John R. Mashey says he suffered a heart attack amid the constant travel. He has re- covered, but the grueling pace left no time to look ahead. By December, 1994, when Time Warner and SGI finally launched a downsized digital cable-TV trial in Orlando eight months late, cab- le companies already were realizing that interactive TV wouldn't pay off. "Interactive TV was dying, and the Internet was taking off," says John Danner, an SGI manager who left in 1995 to start Net advertising software startup NetGravity Inc. "But SGI was still gung ho on i-TV."

SGI didn't ignore the exploding Web. But after initial success running busy sites and selling the first dedicated Web servers

APRIL 25 SGI reports another disappointing quarter—this time because partner NEC can't produce enough SGI-designed MIPS chips.

JULY 31 Chief Operating Officer Tom Jermoluk resigns to become CEO of @Home, a startup build-



ing a high-speed backbone for delivering Internet content over cable TV systems.

SEPT. 25 Partly because of a \$10 million charge to replace thousands of defective MIPS microprocessors, SGI says it will report first-fiscal-quarter results well under expectations.

JERMOLUK



OCT. 7 SGI introduces \$6,000-O2 workstation to compete against high-performance PCs.

OCT. 17 SGI reports a first-fiscal-quarter loss of \$22 million on sales of \$766 million, up only 1%.

JAN. 28, 1997 At SGI board meeting, directors tell McCracken to get SGI back on track.

starting in early 1995, SGI didn't invest much. By spring of 1996, there were fewer than a dozen business people in the division. And while Sun has made its Java software into a broad standard for creating Net applications, SGI's 3-D Net software has been slow to take off because of networking bottlenecks. As a result, SGI lost momentum to Sun, now the darling of the Net.

The Internet's singular potential should have been more obvious to Jermoluk than to anyone. In late summer, 1994, Clark had offered him the CEO spot at Netscape. But Mc-

Cracken didn't want to lose Jermoluk, least of all to Clark. So to keep him, SGI offered the

young president a new compensation package valued at \$10 million-plus over four years. He stayed.

By then, SGI was facing a more fearsome challenge: the omnipresent PC. Souped-up desktops with off-the-shelf Intel chips and Microsoft's business-strength Windows NT were starting to do more of the complex graphics jobs that workstations using Unix software, such as SGI's, routinely tackled. But SGI, at Jermoluk's insistence, refused to support NT—he says it didn't offer SGI a way to set itself apart.

IN THE CROSSHAIRS. By mid-1995, however, none of those simmering problems had yet spilled onto the income statement. A week after its stock hit an all-time high of 44% on July 17, SGI reported a 58% jump in profits on a 45% rise in sales, to \$2.2 billion, for fiscal 1995. To reward employees, SGI spared little expense: It hired Huey Lewis & the News for an all-hands meeting at the company in July and gave all 6,300 employees bonuses or a Swiss watch worth several hundred dollars. That still left plenty of cash to keep hiring 500 people a quarter and investing in new ventures—such as a \$50 million joint digital studio with Steven Spielberg's DreamWorks SKG.

Success put SGI squarely in nearly every computer maker's sunsights. HP introduced higher-performance 3-D graphics workstations, and Sun wasn't far behind. So SGI had to run even faster. In July, 1995, out came the Indigo2 IMPACT workstation line for the technical market, and SGI boldly predicted it would feed \$1 billion into company coffers. At the same time, engineering teams were scrambling to ready a slew of work-

stations and servers for its biggest product introduction ever planned for January, 1996. But the path to the new-product introduction took a nasty turn. On Oct. 19, SGI announced lower-than-expected revenues for the first fiscal quarter. McCracken said the problems were temporary, blaming them on a sales force shakeup and assuring analysts that he expected sales to grow 40% for the fiscal year.

The real problems ran far deeper. Even at \$2.2 billion, SGI was a corporate adolescent. For one thing, engineers and sales people constantly pushed the envelope—and sometimes tore it. For instance, SGI tapped Toshiba Corp. to make key graphics chips for the Indigo machine, though Toshiba had never made them before. What's more, Toshiba execs say the chips required leading-edge design and manufacturing technology. The result: The chips took longer than expected to produce, leaving big shortages.

Worse, SGI's product divisions were so independent that they didn't bother coordinating introduction schedules. "Things always got slammed into manufacturing in the last three weeks of the quarter," says a former manager. By the end of the year, the new workstation and server products stacked up, and manufacturing was overwhelmed. "My team was quite frankly pissed off," says Stephen A. Goggiano, senior vice-president of worldwide manufacturing. Says Jermoluk: "It was like trying to shove a pig through a snake." What came out wasn't pretty: December-quarter sales grew only 22%. Investors dumped the stock, driving it down 16%, to 23%.

Customers were getting angry, too. One longtime SGI loyalist, Tektronix Inc.'s Color Printing & Imaging Division, dropped SGI and bought 100 new Sun workstations instead. Why? Engineering Support Manager Andrew Finkbeiner didn't believe SGI salespeople's insistence that they would ship on time. Up until then, says Finkbeiner, SGI's machines were so much better that he put up with late delivery, frequent breakdowns, higher prices, and steep maintenance costs. Now, he says, "there's no reason to put up with all these things anymore." Meanwhile, Sun was going Hollywood. The company stole some of SGI's Tinseltown thunder by persuading Steve Jobs's Pixar Animation Studios to buy 117 Sun computers, in addition to SGI machines, to help create the graphics in *Toy Story*.

Cover Story

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FEB. 18 SGI's sale of computers that end up in a Russian nuclear bomb design facility prompts a federal probe.

MARCH 24 Intel Chairman Andy Grove announces the "visual computing" era for powerful PCs, stealing SGI's onetime tagline.

APR. 17 SGI announces seventh consecutive earnings disappointment. The stock plummets 24%, to 12%, its lowest point in more than four years.

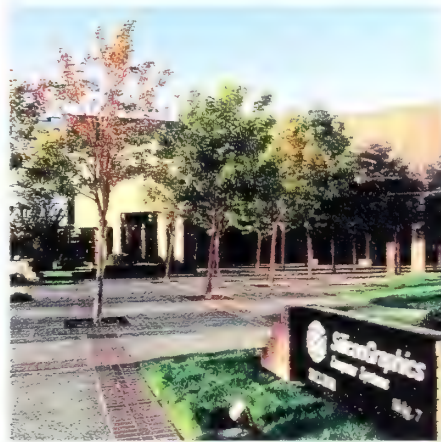
MAY 5 Chief Financial Officer Stan Meresman and Mike Ramsay, senior vice-presi-



dent in charge of desktop computers, leave in a reorganization. Former Cray President Robert Ewald takes over all computer manufacturing and engineering.

JUNE Dataquest Inc. says first-quarter NT workstation shipments boomed 242%, compared with only 10% unit growth for Unix workstations.

JUNE 26 To save money, SGI asks 7,000 U.S. employees to take two extra days off before the July 4 holiday.



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Still, Jermoluk continued to run SGI as if it were a startup. Executives manned the factory into the night the last day of each quarter, scrambling to get shipments out the door. "I was there at the end of every single quarter until midnight," recalls Jermoluk, who did everything from soldering wires on computer boards to putting disk drives into systems to banding boxes for shipment.

REINS. The hands-on management style that had worked for a much smaller company was slowing things down. Instead of changing the way components were supplied to SGI's product divisions to match the company's size, complexity, and pace, Jermoluk simply made all the decisions on which units to fund and get which parts and when. "I just used to do the whole thing myself because I could do it better," says Jermoluk. The board began to notice. "They should have reined him in," says Kramlich. Jermoluk was not disciplined with T.J., and that was a major error.

McCracken had other things on his mind. In early 1996, insiders say, Sun CEO Scott G. McNeley—fresh from trying to buy Apple Computer 17 weeks earlier—contacted McCracken to disbanding SGI. Neither will comment, but talks moved quickly. One SGI insider says that no formal offer was made, but SGI execs thought the company could fetch \$65 a share; Sun was leaning hard at \$45 a share.

McCracken clearly preferred to play predator to prey. On Feb. 26, SGI announced the purchase of supercomputer pioneer Cray Research Inc. for \$1 billion. In one stroke, SGI became the top supplier in the business of high-speed computing, gaining a seasoned sales force and a new customer base. But few people—especially in SGI—thought the move really improved SGI's prospects. Analysts worried that the market for supercomputers was shrinking and that Cray would take a long time to digest without adding many new customers or addressing SGI's key challenge, "Wintel" workstations. "Why buy a company that was failing poorly in a shrinking market?" asks one exasperated SGI executive. McCracken says Cray has turned around and

also provides SGI with leading-edge technology to trickle down into other SGI machines. But Cray quickly proved distracting at a time when SGI execs had their hands full getting their own house in order.

SGI's growing turmoil was taking a toll on many employees, who bailed out in droves. Two big departures at the senior vice-president level: Wei Yen, who ran the products and technology group, now at NCI Inc., an Oracle subsidiary, and Robert Burgess, who headed the Alias/Wavefront operation, now president of Macromedia. Meanwhile, other employees spied golden opportunities at Net startups that offered more attractive stock options and a brighter future. By spring, 1996, turnover had doubled, to nearly 20%. McCracken says it has since fallen to under 10%. However, at least 16 of 43 top execs have left or were pushed out in the past two years. One executive recruiter stopped trying to tap talent from SGI four months ago. "There's no body left," he says.

Why the big exodus? Managers and employees who thrived on SGI's go-go culture—and others who joined because it was hot—saw a brighter future at hordes of Internet and other startups. Others tired of what one former employee called the frat-house atmosphere. That side of SGI's culture reached a nadir, insiders say, at a July, 1996, European sales conference in Mallorca that attendees are still buzzing about. Several eyewitnesses say a number of managers and executives had too much to drink and caroused late into the morning.

McCracken heard the tales, too. He says he looked into the incident but never determined whether anything untoward happened. Still, he says, he talked about it with other managers. "We certainly spent a lot of time after that meeting discussing what is appropriate behavior," he says. "It's really important that people trust the management of the company."

Jermoluk wasn't the only executive employees were buzzing about. In the spring of 1996, McCracken separated from his 48-year-old second wife, whom he had met in SGI's human-resources department before they were married in 1985. The split

**TURNOVER
DOUBLED
TO 20% IN
1996 AS
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left both struggling to meet expenses, according to court filings. McCracken, who didn't get a bonus last year, had to liquidate assets and borrow money to pay expenses before the divorce became final this past June 18.

But what made the split news inside SGI was McCracken's new relationship. McCracken began to date a young woman,

who, as his wife once did, worked in SGI's human-resources department. McCracken did

Cover Story

not try to hide their involvement: They displayed each other's photos on their desks and were kissing at an SGI party for customers and employees at last summer's Siggraph graphics industry conference in New Orleans.

McCracken defends the relationship. "I've done nothing to hide it from anybody," he says. After it started, he says, the woman switched to another job at SGI so she would be less involved in current employee matters. However, some employees say the relationship has eroded their trust and confidence in McCracken since she's still with the company.

To some staffers, it was one more sign that executives had lost their way. Indeed, after two more burn quarters, it was clear Jermoluk was having trouble getting the company back on track. On July 31 of last year, he left to become CEO of @Home Corp., a cable Net service. Jermoluk admitted his heart wasn't in SGI anymore: "I'm a builder, less a sustainer."

Once McCracken took over daily operations, he realized how bad the problems were. In July, SGI started getting alarming calls from customers: Their new SGI computers would sometimes shut down without warning. Engineers found a flaw in the new microprocessors and traced it to a production problem at the maker, Japan's NEC Corp. NEC says it replaced every one of the chips—which were scattered around the world in some 4,000 systems. Still, it cost SGI a cool \$10 million to send out field engineers to make the replacements.

That was just one sign that the company's basic processes—like quality control—were in tatters. Even SGI's new strategy to broaden its market by courting commercial buyers—such as Procter & Gamble and PepsiCo—was troubled. As it turns out, those customers tend to be conservative, preferring to wait until new products have been in the market for some time.

OVERWHELMED? Amazingly, SGI's demand-forecasting model hadn't factored that in, says manufacturing chief Goggiano. The result: So many customers bypassed the new machines and kept buying the older ones that SGI ran out of those by Thanksgiving. The shortfall put salespeople under even more pressure—with one glaring result. Late in 1996, SGI sold four powerful servers worth \$650,000 to a Russian facility that designs nuclear warheads. Salespeople didn't bother to check out the well-known facility, which had simply changed its name to All-

Russian Scientific Research Institute for Technical Physics. Assuming it was a research institute, SGI didn't apply for the normal government clearances. The company says it is cooperating with an ongoing federal investigation.

Now, it seemed, SGI was in free fall. After reporting another poor quarter on Apr. 17, the stock plummeted 24%, to 2 1/2, its lowest point in more than four years. SGI's board had no choice. At its regular April meeting in Eagan, Minn., SGI headquarters, they canceled a planned tour of the facilities to nail down financial goals. "You bet your life that as time has been going on, we've been asking harder and harder questions," says board member Robert A. Lutz, president of Chrysler Corp. "The company was continually overwhelmed by everything. At some point, things have to improve."

McCracken didn't take long to set the new agenda. On Apr. 15, he announced a reorganization that shook up his management team. Out the door: 11-year veteran Michael Ramsay, eight-year Chief Financial Officer Stanley J. Meresman. Not out: computer engineering and manufacturing—once split into

several groups, each fighting for resources. Now, all is under the command of Executive Vice-President Robert H. Ewald, former president of Cray and a possible successor to McCracken. The goal: better coordination between research and development and manufacturing—a big source of SGI's problems.

Now, McCracken and Ewald have a chance to avoid Apple's fate. SGI's high-end graphics are still unbeatable. The Jet Pulson Laboratory is using SGI supercomputers and workstation process images for the Mars Pathfinder landing, and SGI computers were pivotal in the recent *Jurassic Park* sequel, *The Lost World*. "There's still

a large productivity gap between what you can do on any workstation and on a PC," says Martin Plaehn, CEO of Viewpoint Software Inc. in Orem, Utah.

SGI is even swallowing its pride and working on a workstation that will use Intel chips and Windows NT. But it may be a year before it's ready. Says former SGI Vice-President Loevner, an Apple alumnus and now CEO of Internet Shopping Network: "They thumbed their noses at Apple for getting blindsided by Microsoft, but SGI got blindsided even worse."

Indeed, whether McCracken's effort will be enough to restore SGI to its former glory is doubtful. In most of these new commercial markets, SGI's machines don't offer much more than the chines from IBM, Sun, and HP. And it's far less experience in selling to those customers. "For Silicon Graphics to pull that off now is going to be very difficult," says Morgan Stanley, L.P. Witter, Discover & Co. analyst Steven M. Milunovich.

The toughest job for SGI—the company that pioneered virtual computing—will be visualizing a new future for itself.

By Robert D. Hof in Mountain View, Calif., with Ira Stine in New York and Linda Himmelstein in San Francisco

GRAPHIC LESSONS FROM SILICON GRAPHICS

BLUNDER Set overly ambitious sales goals, aiming to grow 50% a year

BLUNDER Pursued glittery markets such as interactive TV that fizzled, while ignoring the inexorable rise of PCs

BLUNDER Built inadequate business processes like inventory management and demand forecasting, leading to product shortages and angry customers

BLUNDER Cray Research acquisition sapped management energy from more pressing problems such as getting products shipped out on time

BLUNDER Went for higher margins instead of market share, leaving it struggling for scale against IBM, HP, and Sun

SOLUTION Lowered expectations to 20%, closer to the growth of the high-end market

SOLUTION Refocused on fast-growing markets such as telecommunications and started work on PC-based workstations

SOLUTION Stopped shooting from the hip and started putting in systems, from quoting an order to scheduling manufacturing to collecting payments

SOLUTION Consolidated all manufacturing and engineering operations under one person, Executive Vice-President Robert Ewald

SOLUTION Focused on niches such as data mining and massive corporate databases, where ultrafast computing is critical

MICHAEL EISNER DEFENDS THE KINGDOM

Disney's boss talks tough about boycotts, *Hercules*, ABC, and succession

With everyone from the Baptists to the Catholics to the blind protesting one of his policies or products, it's no wonder Chairman Michael D. Eisner isn't, well, defensive. Thanks to a long string of missteps and disappointments in recent months, Disney Co.'s stock is down 8% from its May high of 84%, despite a

holders are still smarting over the estimated \$100 million it cost to get rid of short-lived company President Michael Ovitz, and a \$250 million suit brought by another departed Eisner foe, Jeffrey Katzenberg, may go to trial this fall. Eisner still faces criticism that he can't share power.

But most troubling is the anemic performance of Disney's newest animated

the company. Why is everyone taking shots at you now?

A: The company is big, and therefore visible. A lot of people are interested in seeing whether we are going to slip up.

Q: Will the Baptist boycott hurt Disney?

A: No. I'm sorry if [the *Ellen* episode in which the lead character declared herself to be a lesbian] offends the Baptists. I

may not be as religious as some, but I went to a Baptist college [Denison], and I grew up believing that tolerance was the basis of all religions. I think that's what's missing here—tolerance.

Now, I got this letter from a group of non-big-time Catholics about *Nothing Sacred* [a show about a doubting priest that debuts on ABC this fall]. They haven't even seen the show. They are criticizing it off of a sentence that they read in the press somewhere. I showed that show to five priests. We try to be careful, to make changes. And then we

get this reaction. It's aggravating.

Q: Disney's stock price has taken a fall, largely based on the disappointing box office for *Hercules*. What's wrong with Disney's animation unit?

A: Nothing. I don't think people quite understand our company. We have many avenues to make money from one of our animated films. The video revenues from one of our animated films are large, the consumer products huge. We're soon going to open our 11th *Beauty and the Beast* stage show. I'm

BEYOND THE BOX OFFICE

“I don't think people quite understand our company.... The video revenues from one of our animated films are large, the consumer products huge”



on July 22 when the company passed Wall Street estimates with 8% earnings increase. Each pass-week seems to bring Eisner new sales. The company recently recalled 100 Insane Clown Posse albums, a horrified Eisner belatedly got out of the rap group's hard-core sales. ABC, acquired for \$19 billion in 1995, struck two years ago, continuing to be a ratings loser, and its management turmoil is an acute embarrassment to Eisner, once a top ABC executive himself. Share-

holders are still smarting over the estimated \$100 million it cost to get rid of short-lived company President Michael Ovitz, and a \$250 million suit brought by another departed Eisner foe, Jeffrey Katzenberg, may go to trial this fall. Eisner still faces criticism that he can't share power.

But most troubling is the anemic performance of Disney's newest animated film, *Hercules*. Each of the three animated films Disney has released since 1994's *The Lion King* has had progressively weaker results. For a company that derives a substantial portion of its profits from its animated films, that's a disturbing trend.

Ever under the gun, Eisner took a break from his vacation in Aspen, Colo., to talk with *BUSINESS WEEK*'s Los Angeles bureau chief, Ronald Grover, about his and the company's troubles.

Q: It's been a bad couple of weeks for

going to Minnesota soon to see *Lion King* [on stage]. This company has a multiple strategy to recreate and grow the Disney brand.

Q: But box office [performance of Disney's animated films] has been going

can. If you could have great entertainment and not as great profits, or great profits and not as great entertainment, I'll take the great entertainment every time. You keep making great entertainment, and the profits are sure to come.

PRODUCT VS. PROFITS **44** Look, the audience may or may not be with you with every film you make. . . . You keep making great entertainment, and the profits are sure to come **77**

down since *Lion King*, and that can't be a good trend for sustaining that strategy, can it?

A: The trend is just fine. You keep looking at trends, and pretty soon you've trended yourself right out of business. I think *Heracles* is a fabulous movie, I thought *The Hunchback of Notre Dame* was a fabulous movie. Look, the audience may or may not be with you with every film you make. But our job is to make the best entertainment that we

Q: ABC's recent decision to deny Fox airtime during *Wonderful World of Disney* for commercials for its animated film *Anastasia* shows increased worries about all the studios taking on Disney animation, no?

A: Look, I hope they all start making animated films, copying what we have done. As they copy [us], we went out and made the live-action version of *101 Dalmations*, which was a big success. Our strategy has to be, if they go

one way, we're going to go another

Q: What was the problem with the *Musical* *Sane Clown Posse*? How did that slip through the cracks?

A: Has BUSINESS WEEK ever made a mistake? Have you ever made a mistake in your life? We made a mistake. The moment I heard the music, I knew this was something that this company couldn't release. But you can bet that won't happen again.

Q: Can we discuss the problem at ABC?

A: ABC is not a problem. We bought ABC [because we wanted to ensure that Disney [wouldn't] be shut out from reaching the audience—not by Rupert Murdoch, John Malone, or Bill Gates]. It was apparent that we had to have a distribution. [ABC] had a full range of distribution—the network, cable, and stations—that were hedges against getting shut out by someone else.

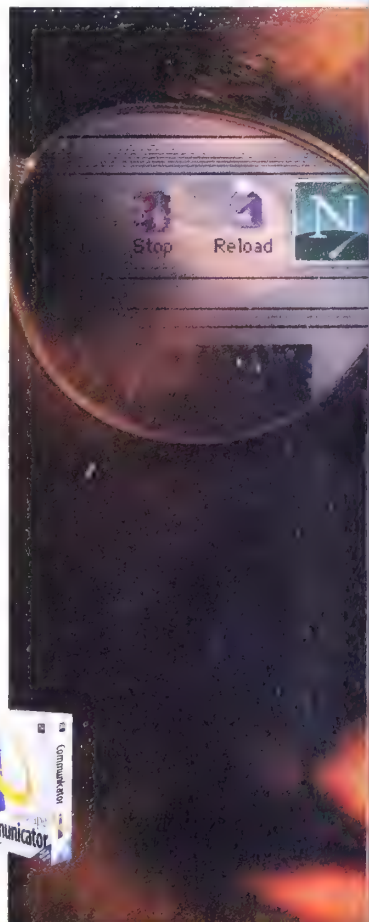
Maybe I share some of Walt's paranoia that we were the skinny kid in the block and you have to protect yourself if you're weaker than the other. With the deal, we added a lot of balls. We added cable with [80% owned] ESPN and [50% owned] Lifetime,

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broadcast entering a digital world, are powerful assets to keep the by brand available to the public.

re, but did it justify spending \$19 n for a network that fell in the gs so quickly?

le looked at other networks, and ide more economic sense to spend illion and get the full range of assets. We sold off \$3 billion of [ishing] assets, so we paid \$16 bil- or an asset that we think is worth r \$20 billion right now—or will be, we get the ratings fixed.

he concern among many is that e spending too much time your- rying to fix ABC and ignoring other ts of the company. True?

spend one-fiftieth of the amount of at ABC that I do on animation, one-hundredth the amount of time I spend on the theme parks. And I l zero time on development, zero. I the pilot meetings, and I screen pilots. But [ABC President] Bob 'l and his team don't need me. re I think I can add something of e, I will. But my secret dream is I could go down to the smallest office somewhere, where people t know me, and really see what I do.

Q: With all that's going on, don't you need a strong No. 2 to help out?

A: At the moment, we have four or more strong No. 2s. Joe Roth at the studio. I couldn't do better than Bob Iger. I couldn't do better than [Disney cable's] Gerry Laybourne or [ESPN's] Steven Bornstein or [theme-park chief] Judson Green or [CFO] Richard Nanula. We have the strongest team around.

because of your health problems, wasn't it?

A: Right, but things have changed.

Q: Is there a succession plan for the company?

A: Sure, I discuss my ideas of succession with the board all the time. If I got hit by a truck tomorrow, there would be someone to run this company, and my

PASSING THE TORCH 44 If I got hit by a truck tomorrow, there would be someone to run this company, and my ego is such that they would probably run it better than I have 77

I went in a different direction once with you-know-who [Ovitz], and it obviously was not successful. I like being part of a team, but the team doesn't have to be the same person each time. I can be a team with Joe on movies, with Bob at ABC. It's just a different way of looking at No. 2.

Q: Sure, but back in '95, when you hired Michael Ovitz, it was your wife who suggested you needed the help

ego is such that they would probably run it better than I have. I am 54 years old, and if it hadn't been for my [heart] bypass, no one would even be talking about succession. A person at any age is vulnerable, so we've talked over what might happen. But there is no No. 2 waiting out there if we had to use the plan. There is a group of people both inside and outside this company who could run it if I wasn't here. There isn't a concrete plan at the moment.



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IS RICK SCOTT ON THE CRITICAL LIST?

Columbia/HCA's CEO may have made too many enemies—including some on his own board

It was only a year and a half ago that Dr. Thomas F. Frist Jr. and Richard L. Scott flouted decorum by exchanging high fives in the dining room of Nashville's exclusive Belle Meade Country Club. But the camaraderie is long gone between Tommy Frist, the vice-chairman and largest individual stockholder of Columbia/HCA Healthcare Corp., and Rick Scott, the chairman and chief executive of the embattled hospital colossus. "I wouldn't say that Tommy is angry," says one confidant, choosing his words carefully. "He's focused. Very focused."

With revelations about the widening scope of the government's criminal investigation of Columbia appearing almost daily, a behind-the-scenes campaign to rein in Scott—or perhaps remove him altogether—seems to be coalescing around Frist, who at 58 is the very model of the patrician physician. The 24% drop in the company's stock since February is both a symptom and a cause of the growing disillusionment with Scott among large investors. Even Texas billionaire Richard Rainwater, who co-founded Columbia Hospital Corp. with Scott in 1987 and has been his biggest booster ever since, may be wavering in his support.

IN-YOUR-FACE. While Scott's personal culpability in the unfolding scandal is uncertain and likely to remain so for months, the 44-year-old CEO clearly has become a political liability. Under Scott's relentlessly aggressive leadership, Columbia has made scores of powerful enemies at every level of government. "To paraphrase Tommy, the basic problem is the in-your-face style of Scott coming home to roost," says a Frist ally.

Since March, when

federal agents raided Columbia offices in El Paso and carted out documents by the truckload, Frist has met privately with Scott and urged him to adopt a more statesmanlike stance. Scott listened, but did he hear? Publicly, anyway, the CEO has not conceded that he needs to modify either the substance or style of his approach. "There are certain things beyond your control," Scott told *BUSINESS WEEK* in a June interview. "But what I like about this industry is that if we do a good job of taking care of patients, things will work out."

Also last month, Rainwater reaffirmed his faith in Scott and Columbia's prospects in an interview with *BUSINESS WEEK*. "As far as I'm concerned," said Rainwater, who still owns 9.8 million shares of Columbia stock to Scott's 9.4 million, "Rick will lead the company forever, or until he wants to step down." But on Monday, July 21, Rainwater suddenly backpedaled from his unconditional embrace of the status quo, saying only that significant developments were imminent.

Almost immediately, reports surfaced that Columbia was talking to Tenet Healthcare Corp. about a merger. Both companies declined to comment on the reports. Tenet, the industry's second-largest company, is roughly a quarter of Columbia's size. Its CEO, Jeffrey C. Barbakow, guided the company through its own scandal four years ago when he forged a settlement of massive fraud charges for \$380 million. Many in Washington and in the industry believe prosecutors won't let the next violator off with just a fine, but will seek jail terms.

The rumors gave a lift to Columbia's battered stock, which had fallen as low as 32 as investors fled. The company's largest



NASHVILLE BEEF: Protesters oppose takeovers of community hospitals

stockholder, FMR Corp.—the parent company of the Fidelity family of mutual funds—has unloaded more than half of its 56 million shares since March, paring its interest to about 4%, down from 9%, according to estimates by Axiom Equity Research, a New Hampshire brokerage that tracks Fidelity for institutional investors. "It looks like we have really lost confidence in the company," says David J. O'Leary, president

ha. FMR has declined to comment. ll, the disgruntlement of Frist and Columbia directors poses the imminent threat to Scott. Frist, owns 14.6 million shares, founded tal Corporation of America with ther in 1961 and sold it to Co-a in 1994. While few HCA execu-remain in Columbia's senior man-ent ranks, no fewer than five of its irectors were affiliated first with und and are considered likely to back in any showdown with Scott. e are not the sort of people who

Royal, a Richmond, Va., physician, and Carl Reichardt, the retired chairman of Wells Fargo Bank. The third member is from the Columbia side of the corporate marriage: T. Michael Long, a partner at investment banker Brown Brothers Harriman & Co. A Columbia spokeswoman declined all comment on board matters.

PROBABLE CAUSE. All three members of the special committee declined BUSINESS WEEK's requests for interviews, as did Frist. However, it seems highly unlikely, given the mounting

ready have found evidence of fraud in Columbia's Medicare billings and indictments will be handed down in Florida within a few months.

The primary allegations against Columbia appear to center on overbilling. The *Times* stated that investigators have obtained internal Columbia cost reports and worksheets that contain significantly lower expenses than in reimbursement claims submitted to government agencies. Samuel A. Greco, a senior Columbia financial official, has said that the company has done its best to submit ac-



ONE-MAN SHOW? The hard-driving Scott (right) left Frist (left) and McWhorter in the backseat

curate cost reports. Columbia declined to comment further on the investigations to BUSINESS WEEK.

But the federal inquiry into Columbia is not limited to its cost accounting. Investigators are also trying to determine whether unnecessary blood tests have been routinely conducted at certain hospitals. At the same time, both civil and criminal authorities are looking into the many investment partnerships Columbia has formed with physicians affiliated with its hospitals. Meanwhile, at least two states—Alabama and Texas—are conducting their own inquiries into Columbia's Medicaid billing practices.

However events play out over the next few weeks and months, Richard Rainwater is certain to be in the thick of any attempt to revamp Columbia, if only because he is as close to Tommy Frist as to Rick Scott. Rainwater got to know Frist in the early

Columbia is four times the size of its nearest rival. But by demanding endless growth, Scott has possibly jeopardized his company

sit quietly in the corner if they changes are needed," says a for-ICA executive.

SINESS WEEK has learned that soon the March raid in El Paso, the voted to appoint a special three-a committee to conduct an internal igation into the company's basic ess practices. The panel retained n outside legal counsel and is ex- d to report its findings at the next arly scheduled board meeting on 14. The committee includes two me directors of HCA: Dr. Frank

gravity of the government's probe, that the panel will present management with a clean bill of health.

On July 16 and 17, a small army of FBI and other federal agents served at least 35 search warrants on Columbia facilities in seven states: Florida, Georgia, North Carolina, Oklahoma, Tennessee, Texas, and Utah. To obtain such warrants, prosecutors first must persuade a federal judge that they have probable cause to believe that a crime has occurred. According to reports in *The New York Times*, investigators al-

1980s, before he met Scott, and for a time owned stock both in HCA and Columbia and served simultaneously on the boards of both companies. "Rainwater kept telling me about Rick Scott and how great he was, and I kept blowing it off," Frist told the authors of the book *The For-Profit Healthcare Revolution*.

However, by 1993 Frist had decided that he'd be better off joining forces with Scott and asked Rainwater to introduce him. Columbia paid \$7.6 billion for HCA in early 1994 and capped a memorable year by shelling out \$3.5 bil-

The Corporation

lion to acquire a second Nashville-based hospital company, HealthTrust Inc. The HealthTrust acquisition reunited Frist with R. Clayton McWhorter, a former president of HCA. Frist surrendered his chairman's title to McWhorter and settled into the vice-chairman's role.

Frist could not have found a more dissimilar successor than Scott, who grew up poor in Missouri, the son of a truck driver. After a stint in the Navy, Scott earned a degree in business administration at the University of Missouri and a law degree at Southern Methodist University. Scott joined a big Dallas law firm, where he specialized in merger-and-acquisition assignments for health-care companies and made partner in 1984. Three years later, he joined with two former executives of a Dallas hospital company to make an unsolicited and unsuccessful offer for HCA.

CRITICAL MASS. Not long afterward, Rainwater came calling with an offer the lawyer found irresistible: Join me in starting a hospital company from scratch. Scott put up \$125,000, Rainwater matched him, and Columbia Hospital Corp. was born. The underlying strategy was simple but powerful: to establish the company as the lowest-cost, highest-volume health-care provider in as many cities as possible. In other words, Scott and Rainwater wanted to make Columbia the leading agent of the managed-care revolution that was just beginning to gather momentum in key markets.

Convinced that speed was of the essence, Scott and Rainwater launched the most prolific acquisition binge that health care had ever seen. Columbia reached critical mass in 1993 as Scott pulled off his first megadeal: the \$3.2 billion acquisition of Galen Health Care, formerly the hospital arm of Humana Inc. At 18.9%, Columbia's operating margin for 1993 hugely exceeded the industry average of 13.6% (chart). The company has maintained its superior profitability ever since as the acquisitions of HCA, HealthTrust, and a half-dozen other major companies piled on the volume. In 1996, Columbia reported net income of \$1.5 billion on revenues of \$20 billion.

Even many of Columbia's harshest critics concede that Scott is a brilliant entrepreneur.

"I think he comes in second only to Bill Gates as the businessman of the decade in that he created the business model par excellence for restructuring health care," says Peter Young, a Florida health-care consultant who has been inveighing against Columbia for years. "My problem is with the propriety of its implementation."

As Columbia grew, Scott invested heavily to create information systems that would enable him to closely monitor the performance of each of the company's hospitals and clinics. He imposed precise and highly ambitious revenue and profit goals on his nationwide corps of regional and local managers and yet allowed them considerable operating latitude—an approach that, in retrospect, seems obviously fraught with danger. "One of the basic problems is that when your compensation is tied to the profitability of your hospital or your region, it can cloud your judgment," says a former Columbia executive.

Then, too, in its ham-handed attempts to acquire not-for-profit hospitals—or "nontaxpaying" hospitals, as Scott pointedly prefers to call them—Columbia/HCA offended countless public officials all across the land. In Ohio, for example, Attorney General Betty Montgomery was so outraged by what she characterizes as the "peremptory, bullying" tactics that Columbia employed in its failed attempts to acquire Blue Cross/Blue Shield of Ohio and Massillon Community Hospital that she recently took the company's Ohio chief aside and delivered a blunt threat. Says Montgomery: "I told him that if you want to do business in Ohio, just play it straight from now on. Otherwise, I

will fight you in court any time, anywhere."

In the June interview with *BUSINESS WEEK*, Scott insisted that Columbia had played by the rules in Ohio and everywhere else. He attributed the company's political problems to effective lobbying by not-for-profit institutions that fear having to compete with Colum-

bia. "There are many places where entrenched hospital doesn't want to come in," Scott said. "These people are smart, and they're spending significant amounts of money to fight us."

This is undoubtedly the case. Scott and his lieutenants have fanned the flames by repeatedly attacking the very concept of not-for-profit hospitals even though they still account for more

than 80% of the industry late 1994, according to *Washington Post*, Scott chaired the board of a recently acquired hospital that "taxpaying hospitals should be in business. They're good corporate citizens." At the same visit, David Vandewater, Columbia president, was equally less. "The enemy is Mary's," he told the board referring to a competing for-profit. "They've got patients."

During Columbia's early years, Rainwater proved an effective foil to the ho strong and often impos-

Scott. But as Rainwater shifted his focus to other investments as the company grew, "there was no one [willing] to challenge him, including Tommy Frist," says one insider. Reportedly unwilling to settle for figurehead status, McWhorter signed as chairman in early 1996, but remains a director. Scott promptly claimed the chairman's title for himself. While Frist still keeps an office next to Scott's, it is often unoccupied.

Frist's allies say that they have doubt that he will stand and fight need be. "Tommy has what he built the line," says one. He also has a pile of Columbia stock worth a cool \$175 million less today than before the Federal Bureau of Investigation started raiding Columbia offices earlier this year. However, his allies add, Frist does not aspire to succeed Scott as CEO, except perhaps on an interim basis.

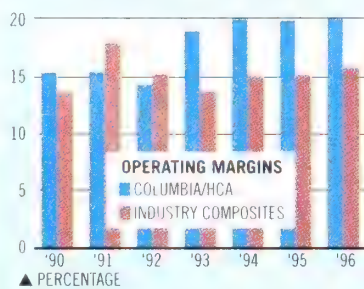
The history of companies that have come under heavy federal investigation suggests that Scott's days as CEO are numbered. And even Scott's greatest champion might not be willing to wait much longer. Says a source close to Rainwater: "As long as Rick's the lightning rod, Rick has done his job, but maybe he's not the right guy to take Columbia to the next level." To put first things first, to come to terms with the U.S. government.

By Anthony Bianco in New York, and Stephanie Anderson Forest in Dallas



JULY RAID: The FBI has served Columbia with 35 search warrants

COLUMBIA BEATS RIVALS BY A WIDE MARGIN



DATA: STANDARD & POOR'S COMPUSTAT, A DIVISION OF THE MCGRAW-HILL COMPANIES



BETH PRITCHARD

BORN 1947, Milwaukee

EDUCATION BA, international relations, University of Wisconsin in Milwaukee, 1969; MBA, Marquette University, 1971

CAREER 1969-70 Central Intelligence Agency: trainee
1971-72 Schlitz Brewing: manager of new-product development
1973-91 SC Johnson: last title, vice-president in charge of insect control
1991-present Head of Bath & Body Works; became chief executive in 1993
1996-present CEO of Victoria's Secret Bath & Fragrance

MADE HER MARK The onetime bug-spray chieftain has used her marketing prowess to build BBW into the leading bath-shop chain

FAMILY Married to John, an attorney, for 25 years; daughter, Ashley, 15

HOBBIES Skiing and tennis

TAILERS

THE McDONALD'S OF TOILETRIES'

Beth Pritchard has big plans for Bath & Body Works

Vhen Christmas comes, look for Beth M. Pritchard wearing reindeer antlers while she sells shampoo at a Bath & Body Works outlet. Pritchard isn't a saleswoman. She's the chief executive of the nation's leading bath-shop chain, one of the brightest spots in The Limited Inc.'s sometimes troubled empire. Every day, she scopes out what's happening in the shops by spending two days in a boutique, where she helps set up displays, stock shelves, and arrange gift baskets. "I'm not really good on the register," she jokes. At 50, the high-energy Pritchard, 50, is finding how her products play is a con-

suming quest. She personally tests many of BBW's shampoos, body lotions, and perfumes in her home. To her husband's dismay, their marble shower is loaded with plastic bottles. Pritchard's 15-year-old daughter, Ashley, and her friends are also willing guinea pigs. And when customers in 1994 griped that a face mask stung, Pritchard had her executive committee use it themselves. When they, too, came away irritated, it was pulled.

Pritchard's personal touch—combined with relentless drive—has helped produce an effervescent growth spurt for a company that, until a few years ago, was barely a blip in the \$26 billion personal-care-products market. When

Pritchard took over Bath & Body Works in 1991, it had just 95 stores with sales of \$20 million. By 1996, she had expanded the chain to 750 stores as sales hit \$753 million. Her goal is to make BBW "the McDonald's of toiletries." She plans to have 950 shops nationwide by yearend, with a long-term goal of 1,700. In five years, she's aiming for sales exceeding \$3 billion. Plus, she is expanding BBW overseas and has started a household-accessories offshoot called Bath & Body Works at Home.

That's quite an achievement in a crowded market. BBW has elbowed past such bath-shop competitors as the Body Shop, now a distant second in the number of U.S. stores. It's also been a boon for BBW's parent which, like many other apparel chains, has been in a funk. Although BBW—which is part of Intimate Brands Inc., itself 83%-owned by The Limited—brings in just 9% of The Limited's sales, it provides an outsize share of profits. J.P. Morgan & Co. analyst Maura Hunter Byrne estimates that BBW had a \$192 million operating profit for 1996, up 55%. That's almost 30% of The Limited's operating earnings of \$636 million. Margins hit 25.5% in 1996, well above the industry average.

Pritchard has designed BBW shops to

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People

have a welcome, down-home feel. They are colorful places that evoke rural America, showing large photos of piled fruit and displaying bath products in old barrels. She's also made innovation a priority: Roughly 30% of BBW's products are new each season, far more than rivals churn out. "Because you don't desperately need our products, we must entertain you," says Pritchard. "It's a Disney mentality."

Unlike the other Limited division heads, Pritchard had no retailing background. BBW's edge is that Pritchard, who spent years as a marketer at Johnson Wax, runs the chain like a consumer-products company, with heavy emphasis on packaging and test-marketing. "We're a brand that happens to have stores that distribute our product," she says.

IT'S A RAID. Before signing on to push perfume and bath oil, she sold something less glamorous: Raid bug spray. For the last six of her 18 years at S. C. Johnson & Son Inc., she was vice-president for insect control, where her canny marketing and product-development skills expanded Raid's market share.

That's what brought her to the attention of Limited Chairman Leslie H. Wexner. The merchandising veteran, who launched The Limited in 1963 and nurtured it into a women's casual-apparel giant, invented the Bath & Body Works concept. But he needed Pritchard's marketing prowess to make it grow. In return, he schooled her in the art of retailing. Says Wexner, who heads both The Limited and IBI: "She is an excellent student to coach."

To this day, Wexner is closely involved in BBW strategy. While Pritchard has a lot of autonomy, she regularly bounces ideas off her retail-savvy boss, who also has put her in charge of the bath and fragrance arm of the Victoria's Secret chain, another IBI unit. "Beth could run her own show without any help," says Donald B. Shackelford, an IBI director. "But it wouldn't be as good a show if Les wasn't there for the strategy and direction."

Managing BBW's rapid growth requires an exec with Pritchard's kinetic style. Her family calls her "the electric lady." On shopping expeditions to search for new ideas, she amazes subordinates

by buying thousands of dollars' worth of merchandise in a quick sweep. "She can do more in an hour because of her incredible focus than I want to do in a day," says Ethan Revsin, an executive vice-president. Despite her killing time schedule and punishingly long work days, Pritchard has mixed her work in novel ways. Wanting to be more of Ashley, Pritchard has taken her daughter on business trips since she was an infant, helped by "a worldwide network of babysitters."

Much of Pritchard's drive comes from what she calls "an incredibly wonderful role model": her mother, Doris

Schuele. Pritchard's father died when she was 10 years young, so her mother worked two nursing jobs to support Beth and her brother. After getting a degree in international affairs in 1969, Pritchard enlisted in the CIA, a popular career choice during the Vietnam War. She wanted to work overseas. She reconsidered after a year, so she got an MBA and embarked on a business career.

BOLD MOVE. For Pritchard, keeping the chain's aggressive expansion with a tricky. "My only concern is: Can she handle the amount of growth?" says Gregory Jackson at

Man Asset management, which owns 2.1 million IBI shares. "So far, she's shown she can." Since BBW is in the top retail malls, Pritchard plans to continue adding stores in locations such as university campuses and strip shopping centers. It's a bold move, since specialty retailers aren't often found there. The soaring margins could begin to show as well. And though overseas markets are promising, U.S. retailers traditionally haven't done well there. She is testing the BBW concept with five stores in Britain, and will roll out more next year.

In the end, the course of BBW's aggressive expansion hinges on how the public goes for the vast number of fruit-based gels and lotions she zealously tests at home—many with names like Country Apple and Peach Nectar. "Hopefully, our products smell so good you'll want to eat them," she says. For the look of her sample-cluttered shelves, Pritchard's BBW will continue to provide The Limited with ample sustenance.

By Lori Bougiorno in Columbus, Ohio

**"Can she
handle this
amount of
growth?
So far she has
shown she
can," says a
money
manager**

ED BY OTIS PORT

W PALETTE THE TALISTE

TS WHO LIKE TO PUT whole arm into their ons will welcome a con-called Digital Artist's m, from Stuart Karten n in Marina del Rey, Instead of sitting in of a computer and mov-mouse, the artist stands nt of a familiar-looking ovel easel, chooses an ionic pencil, pen, or l, and "paints" on a -sensitive screen laid u large plasma or liquidal display. Colors are d on an electronic te—a separate hand-LCD that communicates the easel over a wire-nk. n't look for this easel in anytime soon. Just to a 35-inch display and



IN THE STUDIO: "Painting"

touch-screen for the canvas would cost upwards of \$10,000. On the other hand, says designer Dennis Schroeder, prices for flat screens are coming down quickly, and the rest of the electronics "really aren't such a big stretch." Stuart Karten Design is looking for a manufacturing partner to help build a prototype. *Neil Gross*

IT'S GO TO THE VIDEOTAPE—VIA LASER

RTS FANS KNOW HOW THE GLARE OF ARENA LIGHTS—unshine—can reduce the replays on giant video ens to a pale flicker. But a new system from the poration for Laser Optics Research (COLOR), a 28-son company in Portsmouth, N. H., promises to end squinting. It uses red, green, and blue lasers to duce vivid, contrast-rich images on 9-by-12-foot ens.

he laser projection system caps a nine-year effort olving scientists at Princeton University and Massa-sets Institute of Technology. One big hurdle was deping a blue-laser crystal with enough power—five ts or more—to match the output of existing red and en lasers. COLOR also had to develop new projection nology. Its system harnesses a rapidly spinning mir-to steer the three laser beams, which scan images o the screen line by line.

A 17,000-seat arena in Cincinnati is now installing of the COLOR systems to flash replays during pro-sional hockey and indoor soccer games. "It gives a d, strong, clear picture whether you're below it or to side," says Douglas Kirchhofer, president of Cincin-Entertainment Associates Ltd. COLOR plans to sell system for \$1.2 million—about half the price of other arena screens. And as laser components come down price, COLOR hopes to scale the technology down to fit de ordinary television sets. *Paul Judge*

WEB GRAPHICS AT MACH SPEED

WHAT'S OFTEN CALLED the World Wide Wait may soon turn into the World Wide Whiz, if something called Rush makes good on its promise. It's a way to chop the size of digital images and graphics by 85% to 95%, so the shrunken data almost fly over the Internet.

Despite the extreme reduction, there's no loss of image quality, boasts Robert J. Moran, president of RMX Technologies Inc. in Ottawa, Ont. Rush, he explains, isn't one of those super-duper compression tricks, which inevitably strip away a certain amount of detail. Instead, it's

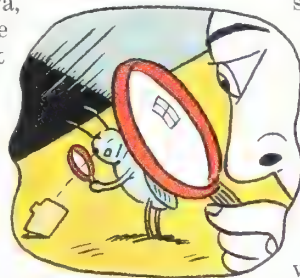
a special software language—one expressly designed to gobble fat graphics files and recompile them. Once an image is

processed, Rush spits out a slim stream of codes containing all the details for reconstructing the original. Then, special plug-in modules for Netscape Navigator and Internet Explorer instantly reverse the process. These modules are already available for free at <http://www.rmx.com>.

Rush is the brainchild of software guru Tapio Vocado, who is currently head of research at RMX. In 1995, he showed it to Moran, who ponied up the

seed money for a SWAT team of programmers to polish the technology. He then coaxed most of the \$3 million invested so far from Bell Canada's venture arm and

Telesoft Ventures Inc., a Montreal venture-capital company. Moran is hoping that content producers and Webmasters will rush to Rush. □



INNOVATIONS

■ The Mega watch from Junghens USA leaves the wearer no excuse for being more than a few nanoseconds late. Each night, the watch resets itself, using an antenna in its leather wristband to pick up the radio signal from the atomic clock at the National Institute of Standards & Technology in Boulder, Colo. The watch waits for dark because radio interference is then at a minimum. But big East Coast cities are so noisy, even at night, that the watch may need to be placed in a westward window. Once set, the \$900 Mega adjusts automati-

cally for daylight savings time as well as leap years and even leap seconds.

■ Five petroleum giants, including Amoco Production Co. and British Petroleum Co., have teamed up to work on a better way of converting natural gas to synthesis gas, or syngas, a building block for liquid fuels and chemicals. They hope to develop a ceramic membrane that will filter pure oxygen from the air and thus eliminate the need for expensive oxygen-production plants. Cheaper syngas would be an environmental plus because fuels derived from it burn cleaner than petroleum-based fuels.

THE ENVIRONMENT

TINY PARTICLES, BIG DILEMMA

The air pollution data aren't clear—so should the EPA be making rules?

It's a monumental regulatory brouhaha. On July 16, the Environmental Protection Agency announced new air pollution standards that not only tightened existing ozone standards but also set limits on a new and previously unregulated pollutant—microscopic particles floating in the air that come from combustion of fuels. According to EPA Administrator Carol M. Browner, a wealth of scientific studies show that the new rules on the tiny particles will prevent 15,000 premature deaths a year once they go into effect in about 2007.

Or will they? Predictably, affected industry groups, along with scores of congressional backers, argue that the research behind the regs is profoundly flawed. But they aren't the only skeptics. Epidemiologist Joseph L. Lyon of the University of Utah likens some of the evidence to "witchcraft." And a recent editorial in the journal *Science* asks how the EPA can protect people from fine particles "if it does not know what they are or which, if any, have deleterious physiological effects?"

"GUINEA PIGS." Supporters of the rules concede they don't understand all the details. But they insist there is more than enough evidence to take action. "If we wait until science gives us all the answers, we are essentially using people as

guinea pigs," says University of North Carolina epidemiologist Carl M. Shy.

The fine-particles debate illustrates the core conundrum of regulation—how to make sound public policy amid uncertainty. Still, most scientists agree that regulating the tiny particles is the right decision. Go back to episodes such as one in London in 1952, experts say. That year, an unusual December weather pattern swathed the city in a shroud of coal smoke and other pollution. In one week, 2,484 people died, up from 945 the prior week. Deaths from bronchitis and emphysema rose almost tenfold, and hospital admissions for all diseases doubled. The lesson: Bad air kills.



That and similar episodes raise key questions. What was the culprit in the witch's brew of air pollution? And was it still a threat at lower levels typically experienced in 1974, when the Arab oil embargo threatened to increase coal use, researchers at Harvard University began a study to find out. They picked six cities, ranging from Steubenville, Ohio, in an industrial region, to the cleaner city of Portage, Wis., and followed thousands of people for more than a decade. The leading hypothesis—that acidic pollution caused discernible health effects—was proven resoundingly wrong. But the study also looked at particles smaller than 2.5 microns in diameter, designated PM2.5, which come from power plants, autos, wood fires, and other combustion sources. The researchers found the death rate to be 26% higher in the coal-burner Steubenville than in Portage. "We could hardly believe the effects were as large as they appeared to be," says Brigham Young University epidemiologist C. Arden Pope III.

It was so unexpected that "we have to verify this," says Harvard epidemiologist Douglas W. Dockery.

DIRT TRAIL
Epidemiologist Dockery found a link between high particle rates and illness

So the researchers arranged to take data the American Cancer Society was collecting on 30,000 people in 151 communities as part of a cancer study. When

ward team added in their pollution data, they found a similar link between particulates and death and disease. In 1993, they were confident enough to publish their findings.

Those results were backed up by a host of epidemiological studies that used a different approach. Researchers used day-to-day records of deaths and hospital admissions and compared them to pollution levels. In city after city, they found an association between particulates and health problems. In Toronto, for instance, "we have evidence for adverse effects of pollution at levels well below the proposed EPA standards," says

David Burnett, senior research scientist for Canada's health agency. Add it up, and there's a "huge body of evidence that particles are related to mortality," says Burnett. That's why public health officials in Canada, Britain, and the World Health Organization have recommended far tighter limits on particulates than the new EPA rules.

But in the U.S., where industry leaders claim the standards would cost hundreds of billions of dollars, the particulate crackdown is far more controversial. Any time a key study is published, critics are out in force within weeks, attempting to poke holes in the analysis. Most experts agree that at least some of the attacks are fallacious. For instance, among the many criticisms in a new book, *Polluted Science*, from the conservative American Enterprise Institute, is the claim that epidemiology is incapable of spotting links as weak as those alleged between particulates and health risks. It is true that for cancer, epidemiologists have a hard time spot-



ting links between environmental exposure and certain relatively rare medical conditions unless the incidence of disease is more than 100% higher. But for more common illnesses, such as heart disease, the task is easier. The risk of disease and death from air particulates is similar to the increased risk of heart disease with elevated blood pressure or cholesterol, says Dockery, "and we don't question those."

Even prominent skeptics agree that the associations are statistically significant. But the critics still question whether the tiny particles are responsible for the statistical jump. Maybe something else that isn't being accounted for in the studies is the real cause. "People who are anxious to show that the sky is falling would be delighted to blame air pollution," says Fred Lipfert, an epidemiologist who recently retired from Brookhaven National Laboratory. "The rest of us would prefer to hang it on other factors, like exercise."

Lipfert suggests that people in Ohio may tend to be more sedentary than

AIR WAR
Mammalian lungs don't have defenses against small particles, says Schwartz

those in Wisconsin, which could explain the higher death rate in Steubenville. But the Harvard scientists retort that Lipfert has no proof that the people followed in the Six Cities study show this pattern—and the researchers did take into account data on body mass index, a rough measure of exercise.

Similarly, skeptics suggest that factors such as humidity or age account for the results. So Pope, Dockery, and others have reexamined their analyses for other causes. Their conclusion: While it's possible to find another explanation for the health effects observed in any one city or study, the alternatives can't explain the overall results.

CHIEF CULPRIT. The question gets thornier, however, when it comes to figuring out why tiny particles are the chief culprit. "It is a very difficult problem understanding how [relatively low levels] can cause the type of morbidity and mortality that the epidemiology seems to find," says lung specialist Mark J. Utell of the University of Rochester medical school. One theory espoused by Harvard epidemiologist Joel Schwartz is that mammalian lungs have evolved defenses against large air particles. But they haven't had time to fashion a defense against smaller particles from burning fuels, which can lodge deep in the lungs and may affect both the immune and central nervous systems. Indeed, there's tantalizing evidence from Harvard's John Godleski, a toxicologist, that already sick animals may die if they breathe fine particles. But most toxicologists say it will take several years to prove if this is true or not.

So it's back to the central public policy dilemma: What to do in the face of scientific uncertainty? For particulates, there's a general consensus among scientists that some regulation is necessary, even if the case hasn't been proved. For one, cutting fine particles will also result in reductions in most of the other pollutant suspects in many parts of the U.S., Burnett says. And one reason the EPA's scientific advisory committee backed a PM_{2.5} standard was to put in place a network of monitors to help resolve many of the uncertainties.

Thus, in five years, when states are scheduled to begin developing plans to meet the EPA's new particulate rules, scientists expect to have a much clearer understanding of the threat particulates pose. While a strong case could be made that we should wait until then to set levels, at that point, this fight may seem like so much wasted breath.

By John Carey in Boston

A DUSTUP OVER PARTICULATES

Are fine particles in the air killing thousands of people a year? Here are the pros and cons of the science behind the claim.

CRITICISM	RESPONSE
SEARCH: The association epidemiologists find between pollution and death and disease doesn't show up in all studies, so it may not be real	Too many studies show an association to simply ignore the problem
RISK: Particles are found to increase risk by only 20%, but since studies are imprecise, scientists usually only worry if risks increase by 100% or more	True for rarer diseases like cancer, but a lower threshold is acceptable for more common diseases
OTHER FACTORS: The increased death and disease may be caused by other pollutants or by factors such as weather or exercise differences	The science is admittedly uncertain—but some studies have been able to finger particulates as the prime suspect

There is a band of people who
live in your neighborhood.

They roam the streets.

And come into your businesses.

Some people claim they are prophets.

Others say they are maniacs
who have so many formulas
running through their heads
and scribble so many configurations
on the backs of envelopes and lunch receipts.

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EDITED BY AMY DUNKIN

WHEN CORPORATE BONDS HIT THE ROOF

With the bond market rallying and with interest rates sinking to levels not seen since last year, you may wonder if there's a way to capture some extra yield. The traditional method is to invest in corporate debt and pick up a few extra points over Treasuries. Trouble is, corporate bonds have been in especially high demand and are trading at historically pricey levels—barely half a percentage point above Treasury securities.

Should you steer clear of corporates entirely? No. Daniel Fuss, manager of Loomis Sayles and Managers bond funds and the nation's dean of corporate bond pickers, recalls even higher prices back in the 1960s. He thinks the current high valuation of corporate bonds relative to Treasuries, given the benign economic and political outlook, could persist "for a heckuva lot longer."

So what do you do? Here's

ings and now is taking bigger risks with bonds of lower quality. Stooping to conquer doesn't work once prices have already been bid up because you're buying less valuable goods at higher prices.

Getting a corporate bond fund's current credit profile from fund companies takes no more than a toll-free call. But they don't make historical records readily available. BUSINESS WEEK asked Morningstar to sift through its database and help pinpoint a few solid investment choices among some 445 possibilities. Beyond focusing on consistency in credit quality, we also asked Morningstar to eliminate funds that charge loads, demand initial investments higher than \$10,000, or are closed to new accounts. In the end, we narrowed the group to four choices, one in each of the following categories: long-term (maturities of 10 years or more); intermediate (4 to 10 years);

That's great if rates keep dropping. Just keep in mind that if rates head north again, long-term funds will suffer the most, and ultrashort funds the least. Remember, too, that if your combined state and federal tax rate is 28% or more, and this part of your bond investment isn't sheltered from current taxes in a retirement account, you'll likely do better buying a municipal bond fund.

LOW EXPENSES. Among the long-term funds, Vanguard Fixed-Income Long-Term Corporate stands out, and not just because it enjoys Vanguard Group's usual edge of low expenses—in this case, just \$28 annually on a \$10,000 investment, vs. an average of \$110. The fund also shows superior consistency and performance. Run since early 1994 by Earl McEvoy, the fund has steadily invested in bonds with an average credit rating of A, while wringing out an annual average total return of 8.73% over the past five years. McEvoy says he doesn't see interest rates falling a lot further this year, and so now he's lowering the fund's average maturity a bit.

In the intermediate-term category, Harbor Bond overcame keen competition from Strong Corporate Bond (800 368-1030) and SteinRoe Income (800 338-2550) funds, each of which has made more money for investors over the past five years. But Harbor, run by William Gross of Pacific Investment Management

(box), accepted less exposure to the risk of higher interest rates and bought higher-quality bonds. In addition, the fund's expenses are only \$70 a year on a \$10,000 investment).

One way Gross squeezed more than 1% a year out of an AA portfolio by adding a larger-than-average mix of mortgage

Funds With Consistent Quality

FUND	AVERAGE MATURITY	AVERAGE CREDIT	AVERAGE ANNUAL TOTAL RETURN*	800 PHONE NUMBER
VANGUARD LONG-TERM CORPORATE BOND	10+ years	A	8.73%	662-7447
HARBOR BOND	4-10 years	AA	8.03	422-1050
FIDELITY INTERMEDIATE BOND	1-4 years	AA	6.46	544-8888
STRONG ADVANTAGE	1 year	BBB	6.58	368-1030

*Five year period ended 6/30/97

SOURCE: MORNINGSTAR INC.

the trick: If you reach for the extra yield that corporate bond funds promise, pick a fund with a habit of sticking stubbornly to targets for its portfolio's average credit quality. In other words, don't buy a fund if it has steadily held bonds averaging AA rat-

ings and now is taking bigger risks with bonds of lower quality.

When you're thinking about where to place new bond-market investments, don't forget that the more long-term a bond fund's holdings are, the more sensitive the fund will be to interest-rate swings.

A BOND GURU PEERS INTO THE FUTURE

Led by Bill Gross, Pacific Investment Management's Port Beach, Calif., is one of the leading bond investors, with \$100 billion in its portfolio. Gross, who manages the Total Return series of funds, discussed the outlook for bonds with Senior Writer Robert in mid-July, as the





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term group comes as a surprise. This fund, despite its name, has characteristics more akin to Morningstar's short-term group. Within the group, it is more sensitive to interest-rate fluctuations than is typical. This will continue to buoy the fund, which has expenses of only \$71 a year on a \$10,000 investment, if rates keep falling. But when

money-market fund and an ultrashort-term corporate bond fund. Ultrashorts don't aim to keep a stable, \$1-per-share net asset value. If you're willing to accept less return for a bit more predictable performance, a money fund is fine for the cash you need to keep within easy reach. With its low fees and recent yield of 5.35%,

rates turn around, this fund will suffer more than its peers, as it did back in 1994, when interest rates surged.

That said, portfolio manager Christine Thompson isn't aiming to make money with bets on interest rates. Instead, she's carefully keeping the portfolio's interest-rate sensitivity steady. She recognizes that corporates are richly priced now, so she is growing more defensive in her choices. But she doesn't see that part of the market crashing. "If I thought it would happen soon, I wouldn't own corporates at all," says Thompson.

There are few differences between a

Vanguard's Prime Portfolio (800 662-7447) is one good choice.

But if you can take a slight risk with your very short-term funds, then you might think about Strong Advantage. It has built a steady record of nimbly handling its lower-quality, BBB bond portfolio, which has produced an average annual return of 6.58% with low volatility.

SHREWD PICKS. Managers Jeffrey Koch and Lyle Fitterer aim to fit in a niche: buying bonds with maturities that are too long for money-market funds but too short for longer-term bond managers. They also target floating-rate bonds of banks such as Citicorp, and they'll even buy higher-grade junk bonds they expect will be upgraded, such as some News Corp. issues. "We want to be able to go through one of the worst bond markets on record and beat money-market funds," Koch says, noting that he came close in 1994, with a total return of 3.6%.

To do that, Koch had to pick his bonds shrewdly and accept some extra risk. You can avoid all credit worries by buying shares in funds that invest solely in U.S. Treasury bonds. But over time, you'll do better by accepting the minimal risks that good-quality corporate bond funds entail. *Robert Barker*

Treasuries was
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fall as low as 5%,

but that would be a cyclical low—6% represents a median level around which the market will fluctuate.

Q: Are corporate bonds overvalued?

A: Very much so. All we need is a mild recession, with a credit crisis here or there, to put a little fear into the market to make corporates most unattractive. Junk bonds would be even worse. It was 1990 or 1991 when we had our last crisis with the banks, and people tend to forget. Even if I'm wrong, and the recession never comes, the fact is, in

this Goldilocks corporate environment [meaning not too hot, not too cold—but just right], you're only getting half a percentage point in yield over and above a Treasury.

Q: Do you own any junk bonds?

A: We have a few, but they tend to be very short [duration], like two- to three-year paper. We have some Time Warner, which we think of as pretty high-quality junk.



Q: How else can you get extra yield?

A: By buying longer-term Treasuries and mortgage-backed bonds.

Q: What's the minimum an individual needs to build a bond portfolio, as opposed to

buying funds?

A: That's a tough one, but I'd say at least \$100,000 to diversify enough in corporates and Treasuries. In mortgages, it would be higher, maybe \$500,000.



LACING UP FOR A MIDLIFE MARATHON

Maybe it was the new \$110 running shoes or a midlife crisis brought on by having turned 42. But one evening, at the crest of a hill near my Connecticut home, I noticed

HEALTH

a different spring in my step. From that point on, I was a runner—not the jogger who had been slogging 2.5 miles a day for 20-odd years. Soon, I entered my first 5-km race and joined a running club.

Well, it's a year later, and with a dozen 5-km and 10-km races under my belt, not to mention a half-marathon race in blistering heat, I am officially training for October's U.S. Marine Corps marathon in Washington, D.C. Why run 26.2 miles? There's no simple answer, but Jeff Galloway, a 1972 U.S. Olympian and veteran of about 100 marathons, offers one that rings true for me: "People are looking for something that gives them a sense of real accomplishment." That may explain why the median age of male marathoners is pushing 40. The fastest-growing group, however, appears to be women in their 20s. The marathon's appeal is

broad enough for aging baby boomers worried about mortality and expanding waistlines, and Generation Xers who revel in the challenge.

Whatever the motivation, how does a first-timer go about it? Let's assume you're running three to

five miles regularly and you're in good health. First, before you embark on any serious exercise program, you should visit your doctor for a complete physical exam. Then, it's time to go to work. There are two basic ways to train, and both require a minimum of four to six months' commitment.

MILES TO GO. One approach is to run four days a week, building up to two 5-mile runs, a 10, and a 20 in one week. This is the regimen favored by *Runners World* columnist Hal Higdon, a veteran of more than 100 marathons. Another approach, favored by Galloway, features twice-weekly maintenance runs of 30 minutes, and long weekend runs gradually reaching 26 miles and beyond. Galloway even encourages walking part of the time. His routine has greater appeal to

NO MERE JOGGER: Smart trains for the big run

me because the limited weekly mileage means less pounding on my large frame. On the off days, I can cross-train by biking or swimming.

If you need the structure of an organized program, those offered by Galloway (800 200-2771) and Higdon (219 879-0133 or www.halhigdon.com) may be the ticket. Higdon is currently running an 18-week program in Chicago geared to the Oct. 19 LaSalle Banks Chicago Marathon. His 600 followers have paid \$90 each. Galloway organizes sessions in 40 cities, usually tied to a local marathon. His six-month program costs \$129. It begins either in April, to focus on fall marathons (Chicago, the Marine Corps, Philadelphia, and New York), or in September, for such winter and spring events as Disney World in Kissimmee, Fla., in January, Los Angeles in March, or Boston in April.

An alternative to these programs is to join a local running club. To find one, call the Road Runners Club of America (703 836-0558) or visit its Web site (www.rrca.org). I run Sunday mornings with the Pequot Runners in Southport, Conn. The camaraderie of a group helps maintain training discipline: Don't ever underestimate peer pressure.

Whichever training program you choose, you should appreciate the nature of the

challenge. Approach it cautiously. First-timers are likely to be on their feet at least four hours during a marathon. The only way to build endurance is to increase your long-distance runs steadily. Novice runners to finish, not to save the speed for short races you can use as a seasoning from the marathon grind. The secret is to go long and slow. That way you will minimize the risk of injury.

CARBO-LOADING. Another way to protect yourself is to choose good running shoes. Heavier runners require extra cushioning, while those with flat feet or who overpronate their feet inward or outward need shoes that compensate. Also, maintain a healthy diet that's high in carbohydrates and low in fats. Alcohol and caffeine are diuretics, so limit their use, especially in the two days of the long run. And the lighter the clothing the better. Synthetic moisture-removing fabrics dry faster than cotton.

Don't forget nourishment before, during, and after a run. I've found high-energy food bars and gels to be useful, while Gatorade and Powerade are most welcome after a long run. Also, don't run on water. No matter how much you drink, it's probably not enough.

Let's face it. You have to be nuts to run a marathon unless you are being chased by an armed bandit. If you train properly, the exhaustion you'll feel at the end of the line will make all the effort worthwhile. *Tim*

From 0 to 26.2 Miles In Six Months

► Run two or three times a week for 30 to 45 minutes at a comfortable pace

► Once a week, run at a pace about two minutes per mile slower than your norm until you get to 12 miles. Then shift to once every other week

at the slower pace until you reach 20 to 26 miles

► Take occasional minute-long walk breaks on long runs

► Give yourself one or two rest days a week, before and right after the long runs

► Bike or swim on off days

► Take time out for injuries

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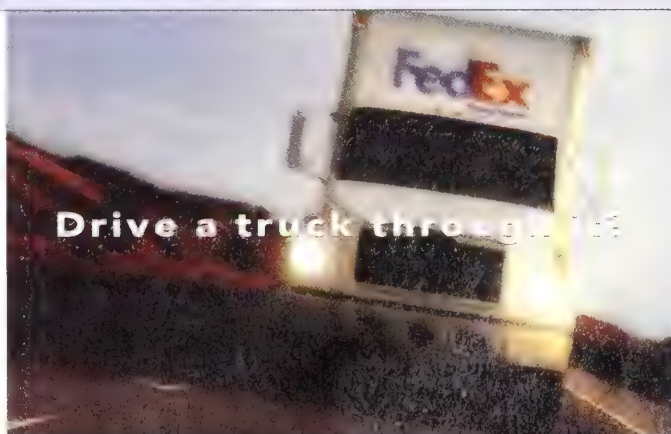
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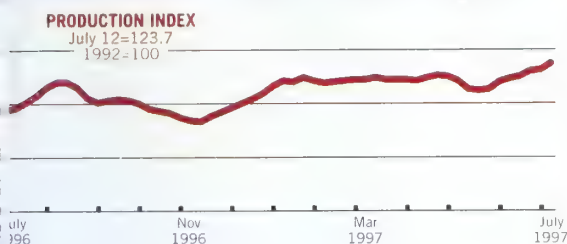
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Business Week Index

PRODUCTION INDEX

Change from last week: 0.5%
Change from last year: 3.5%



The production index increased modestly during the week ended July 12. Calculation of the four-week moving average, the index rose to 124.7, up from 124.2 in the latest week. In the latest week, advances in the seasonally adjusted output of coal and lumber as well as rail-freight traffic offset declines in steel, power, and crude-oil refining production. Auto and truck production were aided by plant closings for model changeovers and some strike activity.

Index compiled 1997 by The McGraw-Hill Companies

PRICING INDICATORS

	LATEST WEEK	WEEK AGO	YEARLY % CHG
PRICES (7/18) S&P 500	915.30	913.68	43.3
RATE BOND YIELD, Aaa (7/18)	7.15%	7.19%	-6.0
RAW MATERIALS PRICES (7/18)	105.6	105.5	-0.7
STOCK FAILURES (7/11)	NA	NA	NA
STATE BONDS (7/9) billions	NA	NA	NA
SUPPLY, M2 (7/7) billions	\$3,935.8	\$3,926.7r	5.0
CLAIMS, UNEMPLOYMENT (7/12) thous.	349	377	-4.1

Source: Standard & Poor's, Moody's, *Journal of Commerce* (index: 1990=100), Dun & Street (failures of large companies), Federal Reserve, Labor Dept

BEST RATES

	LATEST WEEK	WEEK AGO	YEAR AGO
BANK FUNDS (7/22)	5.44%	5.47%	5.25%
GOVERNMENT PAPER (7/23) 3-month	5.54	5.57	5.50
INTEREST RATES OF DEPOSIT (7/23) 3-month	5.57	5.60	5.51
MORTGAGE (7/18) 30-year	7.65	7.67	8.44
FIXED RATE MORTGAGE (7/18) one-year	5.81	5.78	6.21
(7/18)	8.50	8.50	8.25

Source: Federal Reserve, HSH Associates, Bloomberg Financial Markets

Index in the production indicators are seasonally adjusted in computing the BW index (chart); other components (estimated and not listed) include machinery and defense. 1=Western Wood Products Assn. 2=Southern Forest Products Assn. 3=Free market value NA=Not available r=revised NM=Not meaningful

THE WEEK AHEAD

UNEMPLOYMENT COST INDEX

Friday, July 29, 8:30 a.m. EDT ▶ Wages and benefits likely rose 0.8% in the second quarter, says the median forecast of economists polled by MMS International, one of McGraw-Hill Companies. Labor costs increased 0.6% in the first quarter.

CONSUMER CONFIDENCE

Friday, July 29, 10 a.m. EDT ▶ The Conference Board's index of consumer confidence likely rose to 130 in July, after rising to a year-high of 129.6 in June.

RETAIL FAMILY HOME SALES

Friday, July 30, 10 a.m. EDT ▶ New family home sales probably fell to an

annual rate of 815,000 in June, after surging 7.1% in May, to a rate of 825,000.

GROSS DOMESTIC PRODUCT

Thursday, July 31, 8:30 a.m. EDT ▶ The MMS survey expects that real gross domestic product grew at an annual rate of 1.8% in the second quarter, after surging 5.9% in the first. Consumer spending led a slowdown in final demand, but inventory accumulation remained hefty last quarter.

EMPLOYMENT

Friday, Aug. 1, 8:30 a.m. EDT ▶ Nonfarm payrolls likely grew by 200,000 in July, after rising 217,000 in June, says the MMS report. However, the total may be lower

because summer school closings, which should have been captured in the June data, were not. So educational payrolls likely dropped in July. The unemployment rate probably remained at 5%.

PERSONAL INCOME

Friday, Aug. 1, 8:30 a.m. EDT ▶ Personal income and consumer spending each probably increased by 0.4% in June. Both income and spending rose by 0.3% in May.

NAPM SURVEY

Friday, Aug. 1, 10 a.m. EDT ▶ The National Association of Purchasing Management's business index likely edged up slightly, to 56% in July, from 55.7% in June.

PRODUCTION INDICATORS

	LATEST WEEK	WEEK AGO	YEARLY % CHG
STEEL (7/19) thous. of net tons	2,046	2,056#	5.5
AUTOS (7/19) units	113,360	34,982r#	-0.8
TRUCKS (7/19) units	96,933	13,567r#	4.6
ELECTRIC POWER (7/19) millions of kilowatt-hrs	77,484	69,507#	5.2
CRUDE-OIL REFINING (7/19) thous. of bbl./day	14,919	14,914#	5.5
COAL (7/12) thous. of net tons	19,420#	17,531	1.8
LUMBER (7/12) millions of ft.	480.2#	349.7	5.0
RAIL FREIGHT (7/12) billions of ton-miles	24.9#	22.1	-0.8

Sources: American Iron & Steel Institute, *Ward's Automotive Reports*, Edison Electric Institute, American Petroleum Institute, Energy Dept., WPA1, SFA2, Association of American Railroads

PRICES

	LATEST WEEK	WEEK AGO	YEARLY % CHG
GOLD (7/23) \$/troy oz.	324.900	319.500	-15.5
STEEL SCRAP (7/22) #1 heavy, \$/ton	134.50	143.50	0.7
COPPER (7/18) ¢/lb.	112.1	111.1	22.8
ALUMINUM (7/18) ¢/lb	75.0	75.0	9.5
COTTON (7/19) strict low middling 1-1/16 in., ¢/lb.	71.67	70.86	-7.6
OIL (7/22) \$/bbl.	18.76	19.43	-13.4
CRB FOODSTUFFS (7/22) 1967=100	238.67	239.60	-12.4
CRB RAW INDUSTRIALS (7/22) 1967=100	332.72	332.75	-0.3

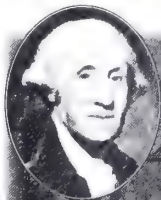
Sources: London Wednesday final setting, Chicago market, *Metals Week*, Memphis market, NYMEX, Commodity Research Bureau

FOREIGN EXCHANGE

	LATEST WEEK	WEEK AGO	YEAR AGO
JAPANESE YEN (7/23)	115.76	116.10	107.93
GERMAN MARK (7/23)	1.82	1.80	1.49
BRITISH POUND (7/23)	1.68	1.67	1.55
FRENCH FRANC (7/23)	6.14	6.07	5.03
ITALIAN LIRA (7/23)	1773.0	1745.8	1516.0
CANADIAN DOLLAR (7/23)	1.38	1.37	1.37
MEXICAN PESO (7/23) ³	7.834	7.916	7.608
TRADE-WEIGHTED DOLLAR INDEX (7/23)	105.3	104.9	97.2

Sources: Major New York banks. Currencies expressed in units per U.S. dollar, except for British pound in dollars. Trade-weighted dollar via J.P. Morgan

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Index to Companies

This index gives the starting page for a story or feature with a significant reference to a company. Most subsidiaries are indexed under their own names. Companies listed only in tables are not included.

A

ABB 6
ABC 73
Adobe Systems (ADBE) 40
Aetna (AET) 28
Airbus Industrie 42
Allianz 54
Alpha Equity Research 76
American Airlines (AMR) 42, 66
American Express (AXP) 6, 62
America Online (AOL) 42, 58, 96
Amoco Production (AN) 81
Andersen Consulting 32
Apple Computer (AAPL) 4, 66, 96
Ascend Communications (ASND) 28
Ashanti Goldfields 58
AT&T (T) 30
@Home 66

B

Bath & Body Works 79
Bay Networks (BAY) 58
Bell Canada 81
Bell Laboratories 66
Big Lots (CNS) 65
Brisson Group 4
Bloomberg 58
Blue Cross Blue Shield of Ohio 76
Boatmen's Bancshares (BOAT) 38
Body Shop 79
Boeing (BA) 42
British Petroleum (BP) 81
Brown Brothers Harriman 76

C

Cambridge Technology Partners (CATP) 32
Carrefour 56
Central Fidelity (CFBS) 38
Champion International (CHA) 28
Chicago Tribune 14
Chrysler (C) 6, 28, 66
Cincinnati Entertainment 81
Circus Circus (CIR) 65
Citibank (CCI) 65
Citicorp (CCI) 86
CKS Partners 66
Coca-Cola (KO) 28
COLOR 81
Columbia/HCA Healthcare (COL) 76
Compaq Computer (CPQ) 42
Consolidated Stores (CNS) 65
Continental Airlines (CALA) 42
Corporate Express (CEXP) 28
Corrections Corp. of America (CXC) 28
Cray Research 66
CRT 32
CUC International (CU) 42
Cyberonics (CYBX) 36

D

Daimong 46
DAIS Group 28
Dell Computer (DELL) 42
Delta Air Lines (DAL) 4, 42
Detroit Newspapers 38

Deutsche Bank 54

Deutsche Telekom 58
Digital Equipment (DEC) 66
Dongbang Peregrine Securities 46
DreamWorks SKG 66
Dresdner Bank 54

E

Eastman Kodak (EK) 30
Electricité de France 56
Endesa 56
ESPN 73

F

Facility Performance Group 40
Fiat (FIA) 56
Fidelity Intermediate Bond Fund (FTHR) 86
Fidelity Investments 76, 86
Firststar (FSR) 38
First Bank System (FBS) 38
First Call 42
First Union (FTU) 38
Fleet Bank (FLT) 4
Ford (F) 14
France Telecom 56
Fuji (FUJI) 30

G

Galen Health Care 76
Galloway Productions 88
Gamma Labs 30
Gannett (GCI) 38
Gateway 2000 (GATE) 58
General Electric (GE) 28, 62
General Motors (GM) 6, 16, 28
Gessy Lever 56
Gillette (G) 28
Goldman Sachs 54
Grace (W.R.) (GRA) 6
Grand Metropolitan (GRM) 42
Gucci Group (GUC) 65
Guinness 42

H

Hambrecht & Quist 58
Hanbo 46
Harbor Bond Fund (HABDX) 86
Harris Webb & Garrison 36
Haworth 40
HealthTrust 76
Heidrick & Struggles 6
Hewlett-Packard (HWP) 66
Hilton Hotels (HLT) 65
Honda (HMC) 16
Host Marriott (HMT) 28
Humana (HUM) 76
Hypothesen- und Wechselbank 54

I

IBM (IBM) 42, 66
Independence Investment Advisors 30
Information Resources 30
Instinet 58
Intel (INTC) 58, 66
Intimate Brands (LTD) 79

Investcorp International 65
Iomega (IOM) 58
Island 58

J

Jinro 46
John Hancock Sovereign Investors Fund 28
Johnson (S.C.) 79
Johnson Wax 79
Jungheims USA 81

K

Kay-Bee Toy & Hobby Shops (CNS) 65
Keefe Bruyette & Woods 38
Kia Group 46
Kmart (KM) 30
Knowledge Adventure 32
Knowledge Universe 32
Korea First Bank 46

L

Leggett & Platt (LEG) 65
Lifetime 73
Limited, The (LTD) 79
LMVH 42
Loomis Sayles 86
Lyonnaise des Eaux 56

M

Macromedia 66
Mattel (MAT) 32
McDonnell Douglas (MD) 42
McGraw-Hill (MHP) 93
McKinsey 32, 46
Mercantile Bancorporation (MTL) 38
Merrill Lynch (MER) 30, 38
META Group (METG) 32
MFK Bank 56
Microsoft (MSFT) 8, 40, 58, 66, 96
MIPS (SGI) 66
Mitsubishi Motor 16
MMS International (MHP) 93
Morgan (J.P.) (JPM) 54, 79
Morgan Stanley (MWD) 28, 65, 66
Morningstar 86
Morton Research 38
Munich Re 54

N

NationsBank (NB) 38
Navio 66
NEC 66
NetGravity 66
Netscape Communications (NSCP) 66
New Enterprise Associates 66
News Corp. (NWS) 42, 86
New York Islanders 4
Nintendo 66
Northern Trust (NTRS) 22

O

Odd Lots (CNS) 65
Omega Advisors 65
Onexbank 56
Oppenheimer 42
Oracle (ORCL) 32

P

Pacific Investment Management 86, 87
Pennzoil (PZL) 42
PepsiCo (PEP) 66

Philip Morris (MO) 6
Pictra 66
Pixar 66
Procter & Gamble (PG) 58
Productivity Point International 32
Prudential 34
Prudential Securities 22

R

Renaissance Solutions (RENS) 32
RMX Technologies 81
Rostelecom 56

S

Sammi 46
SBC Communications (SBC) 32
Sega 32
Signet Bank (SBK) 38
Silicon Graphics (SGI) 6, 32
SmithKline Beecham (SKB) 6
Sony (SNE) 51
Southwest Airlines (LUV) 32
StemRoe Income Fund (SRHX) 86
STET 56
St. Jude Medical (STJM) 32
Strong Corporate Bond Fund (STCBX) 86
Stuart Karten Design 81
Summit Bancorp (SUB) 32
Sunbeam (SOC) 42
Sun Microsystems (SUNW) 66
Svayinvest 56

T

Tektronix 66
Tele-Communications (TCOM) 8
Telefónica de España 56
Telefonos de México 58
Telesoft Ventures 81
Tenet Healthcare 76
3Com (COMS) 42
Time Warner (TWX) 42, 86
Toronto Blue Jays 42
Toshiba 66
Total 45

U

UCAR International (UCR) 58
Union Pacific Resources (UPR) 42
U.S. Bancorp (USBC) 38
USF&G (FG) 28

V

Vanguard Group 4, 86
Vereinsbank 54
Viewpoint Software 66
Vimpel-Communications 32
Volkswagen 56

W

Wachovia (WB) 38
Wackenhut Corrections (WHC) 42
Walt Disney (DIS) 51, 73
Wells Fargo Bank (WFC) 32
Wing Tai Holdings 6

Y

Yacktman Asset Management 79

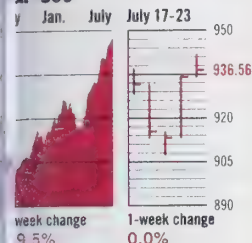
Z

Zions Bancorporation (ZIO) 6
Walt Disney (DIS)

Investment Figures of the Week

STOCKS

S&P 500

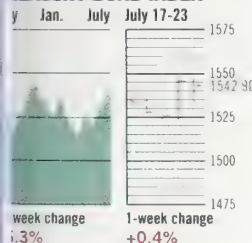


COMMENTARY

earn-burning week in the financial markets. The Dow Jones industrial average, after declining below 7900 on July 18, staged a powerful rally in the days that followed, climbing to just over 8100. Interest rates tumbled, while companies generally reported strong earnings. The market's activity was largely sparked by Federal Reserve Chairman Alan Greenspan, who testified in Congress on July 22 that the recent U.S. economic performance is "exceptional." The dollar, also reacting to Greenspan's testimony, rose to a six-year high vs. the mark.

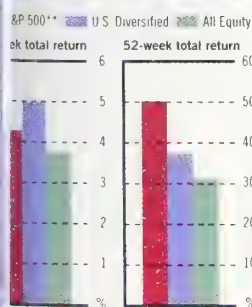
INTEREST RATES

TREASURY BOND INDEX



Bloomberg Financial Markets

MUTUAL FUNDS



Morningstar, Inc.

are as of market close Wednesday, July 23, 1997, unless otherwise indicated. Industry figures include S&P 500 companies only. Fundamentals, technical indicators, Bloomberg mon-

U.S. MARKETS

	Latest	% change Week	% change Year
Dow Jones Industrials	8088.4	0.6	51.1
NASDAQ Combined Composite	1567.7	-0.8	50.4
S&P MidCap 400	307.1	0.2	43.3
S&P SmallCap 600	168.2	-0.6	36.8
S&P SuperComposite 1500	200.3	0.0	48.1

SECTORS

	Latest	% change Week	% change Year
Bloomberg Information Age	296.1	-0.4	62.4
S&P Financials	105.9	0.6	64.8
S&P Utilities	197.6	-2.2	5.5
PSE Technology	324.6	0.4	81.1

FOREIGN MARKETS

	Latest	% change Week	% change Year
London (FT-SE 100)	4874.5	-1.8	32.9
Frankfurt (DAX)	4406.1	4.9	80.0
Tokyo (NIKKEI 225)	20,130.5	-1.1	-2.4
Hong Kong (Hang Seng)	15,738.8	1.9	47.1
Toronto (TSE 300)	6765.2	0.3	37.5
Mexico City (IPC)	4742.1	-0.9	57.9

FUNDAMENTALS

	Latest	Week ago	Year ago
S&P 500 Dividend Yield	1.60%	1.62%	2.29%
S&P 500 P/E Ratio (Last 12 mos.)	23.4	23.5	18.0
S&P 500 P/E Ratio (Next 12 mos.)*	19.0	18.8	NA
First Call Earnings Surprise*	2.55%	1.87%	NA

TECHNICAL INDICATORS

	Latest	Week ago	Reading
S&P 500 200-day average	790.0	784.2	Positive
Stocks above 200-day average	80.0%	80.0%	Negative
Options: Put/call ratio	0.45	0.45	Negative
Insiders: Vickers Sell/buy ratio	2.83	2.42	Negative

Data: Bloomberg Financial Markets; *First Call Corp.

BEST-PERFORMING GROUPS

	Last month %	Last 12 months %
Computer Systems	23.4	Semiconductors 127.7
Oil & Gas Drilling	22.8	Trucking 117.5
Semiconductors	20.5	Computer Systems 113.6
Oil-Well Equip. & Svcs.	20.2	Invest. Banking/Bkrge. 104.6
Communications Equip.	16.7	Savings & Loans 103.8

WORST-PERFORMING GROUPS

	Last month %	Last 12 months %
Metal & Glass Containers	-9.8	Gold Mining -19.9
Photography/Imaging	-6.5	Photography/Imaging -6.9
Hospital Management	-4.0	Manufactured Housing -1.2
Long-Dist. Telecomm.	-3.9	Engineering & Constr. -0.9
Pollution Control	-2.7	Electric Companies 1.1

BLOOMBERG MONEY FLOW ANALYSIS

Rebound ahead? Stocks with most significant buying on price weakness	Price	1-month change
Telebras-ADR	143 1/8	-1 1/8
Pennzoil	76 1/2	-7/8
Bell Atlantic	74 7/16	-9/16
Nynex	56 5/8	-1/4
United Healthcare	53	-1 1/4
Wells Fargo	259 3/4	-16 1/8
Decline ahead? Stocks with most significant selling on price strength	Price	1-month change
Intel	88 3/4	16 3/32
Microsoft	144 1/8	16 1/16
Dell Computer	160	40 9/16
Ascend Communications	52 1/2	12 1/16
Amgen	59 7/16	7/16
Pfizer	61	5 1/8

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 31% federal tax rate.

	10-yr. bond Latest week	10-yr. bond Last week	30-yr. bond Latest week	30-yr. bond Last week
GENERAL OBLIGATIONS	4.53%	4.61%	5.10%	5.18%
PERCENT OF TREASURIES	73.72	74.58	79.33	80.00
TAXABLE EQUIVALENT	6.57	6.68	7.39	7.51
INSURED REVENUE BONDS	4.67	4.72	5.32	5.37
PERCENT OF TREASURIES	75.99	76.36	82.75	82.93
TAXABLE EQUIVALENT	6.77	6.84	7.71	7.78

EQUITY FUNDS

Leaders	Four-week total return	%	Laggards	Four-week total return	%
Fidelity Select Energy Serv.	17.1		Gabelli Gold	-12.7	
Van Wagoner Mid-Cap	16.9		Invesco Strategic Gold	-11.5	
Fidelity Select Computers	16.3		Bull & Bear Gold Investors	-11.0	
Robertson Steph. Info. Age A	15.5		Midas	-11.0	
Amerindo Technology D	15.2		Van Eck Gold Opport. A	-10.7	
Leaders	52-week total return	%	Laggards	52-week total return	%
Lexington Troika Russia	125.8		United Svcs. Gold Shares	-46.5	
ITT Hartford Cap. Apprec. A	97.4		Bull & Bear Gold Investors	-42.2	
Fidelity Select Electronics	91.4		Morgan Stan. Inst. Gold A	-40.6	
Pioneer Growth A	78.8		Lexington Strat. Invmts.	-38.6	
Rydex OTC	77.7		Midas	-36.0	

EQUITY FUND CATEGORIES

Leaders	Four-week total return	%	Laggards	Four-week total return	%
Technology	10.2		Precious Metals	-6.7	
Mid-cap Growth	6.6		Diversified Pacific/Asia	0.1	
Large-cap Growth	6.2		Diversified Emerging Markets	0.2	
Small-cap Growth	6.1		Japan	0.3	
Small-cap Blend	5.3		Latin America	0.4	
Leaders	52-week total return	%	Laggards	52-week total return	%
Financial	54.9		Precious Metals	-27.0	
Technology	50.1		Japan	-3.2	
Large-cap Growth	44.7		Diversified Pacific/Asia	6.5	
Large-cap Blend	43.3		Pacific/Asia ex-Japan	10.4	
Latin America	43.1		Utilities	19.7	

are as of market close Wednesday, July 23, 1997, unless otherwise indicated. Industry figures include S&P 500 companies only. Fundamentals, technical indicators, Bloomberg money flow analysis, and mutual fund returns are as of July 22. For a more detailed explanation, write to us or E-mail figures@businessweek.com. NA=Not available **Vanguard Index 500 Fund

LET THE ECONOMY KEEP CRUISING

History shows that it's all too easy for Federal Reserve policymakers to stumble when the ground shifts under their feet. After the oil price shock of the 1970s, the Fed ran an excessively loose monetary policy, allowing inflation to entrench itself. And too-tight monetary policy in the early 1930s was the main reason why the Great Crash of 1929 turned into the Depression.

The U.S. economy seems to be passing through yet another watershed period now—and so far, Alan Greenspan appears to be doing a better balancing act than many of his predecessors. For now, he sees no reason to raise rates, and rightfully so. Greenspan clearly accepts the reality of the New Economy: the combination of technology, globalization, and other forces that allow low unemployment and strong profits to coexist with low inflation. In his Humphrey-Hawkins testimony to Congress on July 22 and 23, Greenspan noted growing evidence of what he called “basic improvements in the longer-term efficiency of our economy.” Additional support for this view could come on July 31, when the official government statistics probably will be revised to show faster productivity growth in recent years (page 25).

The Fed's next move depends on how the economy does in the rest of 1997. If growth is too strong, or if inflation picks up, Greenspan will be quick to argue for higher rates. If growth slows to a 2% to 2.5% rate in the second half as the Fed and most forecasters project, some may argue that rates should decline. Our own view is that the economy can and will grow closer to a 3% rate in the second half—and that productivity gains will continue to keep inflation in check. Greenspan will probably sit tight the rest of the year, and that's fine with us.

SILICON GRAPHICS' CAUTIONARY TALE

In Silicon Valley (to paraphrase Leo Tolstoy), successful companies are all alike, while every unsuccessful company is unsuccessful in its own way. Despite the region's glittering reputation, flameouts do happen. And when the mighty stumble, the fall can be spectacular. Look at Apple Computer Inc., which makes the critically acclaimed Macintosh technology that may one day be a relic, and which has had a long and painful corporate unraveling that recently was capped by CEO Gilbert F. Amelio's departure. Equally startling is the abrupt free fall at Silicon Graphics Inc. Here was a company that had everything going for it: cutting-edge workstations, ballooning revenues as recently as two years ago, and a chief executive who was a White House regular. Like successful companies in Silicon Valley, SGI seemed to have the Midas touch (page 66).

But good managers, even in Silicon Valley, know there is no

place for hubris in a hotly competitive, constantly evolving marketplace. Flexibility, adaptability, and nimble shifts in strategy assure success. While SGI sold its vaunted workstations, PC makers were making more and more powerful machines, which are catching up fast with a lower-cost business model. And while SGI waded into new markets such as interactive TV, the Internet revolution was capturing the attention of dozens of neighboring companies in the Valley. Amid these challenges, SGI's chief executive was having an office romance, while other managers engaged in behavior more appropriate to a frat house than a corporate office. Bad luck and bad strategy at SGI combined to pull the company down—and now a new set of deputies to the chief executive must try to turn things around. It's a sorry tale and a cautionary one.

NYSE VS. NASDAQ: INVESTORS WILL WIN

It was only a few years ago that the venerable Big Board seemed to be showing its age. Where did the brash young high-tech companies go to float new offerings? NASDAQ. Why did the action increasingly seem to be, as more and more small companies rose in importance, and the volume of trading in their shares grew and grew? NASDAQ. Slowly but surely, though, the New York Stock Exchange has reinvented itself. Clubbiness is out—witness the elevation two years ago of Queens (N. Y.)-born Richard A. Grasso, a 30-year NYSE employee, to the chairmanship of the NYSE. The old hidebound mentality is out, too. Grasso has embraced technology programs that his predecessors launched and made a concerted effort to raise the exchange's global profile. Today, a seat on the exchange goes for a cool \$1.35 million, and the NYSE is drawing big high-tech names such as America Online Inc.

There's no doubt that the NYSE has profited of late from NASDAQ's woes; in 1996, the Securities & Exchange Commission accused market makers of colluding to set prices, the National Association of Securities Dealers, NASDAQ's parent, was required to shore up regulatory operations. But NASDAQ is marketing itself aggressively these days to defend its turf. The battle has been joined between the NYSE, home of the highly automated specialist-trading system, and NASDAQ, home of the computerized market-maker system (page 5).

The NYSE has generally higher listing fees but can boast a strong brand identity, wide global reach, and a vigorous regulatory effort. Spreads are narrowing on both the NYSE and NASDAQ, so neither may be able to claim an advantage there. But multiple market makers on NASDAQ offer comparable liquidity, and many giants that got their start on NASDAQ, such as Microsoft Corp., are loyal. Meanwhile, rising waves on the sidelines are computerized alternative trading systems, which are handling more transactions for powerful institutional traders. Add it all up, and the world of investing is more competitive than ever. For companies raising capital, as well as for investors, that can only be good.

BusinessWeek

ST 11, 1997

A PUBLICATION OF THE MCGRAW-HILL COMPANIES

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WANTED A FEW GOOD CEOs

Why Managing Succession Is Such A Problem

PAGE 64



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COVER STORY

WANTED: A FEW GOOD CEOs

Why picking the next occupant of the corner office is so tough, and what companies ought to do about it

page 61



BusinessWeek

AUGUST 11, 1997

Cover Story

64 WANTED: A FEW GOOD CEOs

The vital issue of who will lead a company in the future gets too little attention in Corporate America's executive suites and boardrooms. If the messy melodramas recently played out at Apple and AT&T are to be avoided, a succession plan, developed by the board, should be in place at all companies, and insiders should be groomed for the top job. That's how to avoid ugly surprises

69 THE TOP 20 HEADS TO HUNT

A BUSINESS WEEK poll of rising CEOs

News: Analysis & Commentary

28 A BUDGET FULL OF GOODIES

While the deal could end the deficit as early as next year, there is more spending in it than there is reform

30 SIZING UP THE TAX DEAL

Figuring the winners and losers in the \$94 billion, five-year pact

32 GUESS WHO'S IN THE WAITING ROOM

The feds widen their crackdown on Medicare billing fraud

33 COMMENTARY

If the FCC wants to stay relevant, it had better untangle local telecom monopolies while it still can

34 BATTLE STATIONS! BATTLE STATIONS!

Armed with new chip and software technology, PC makers are gaining in the \$15 billion workstation market

34 SILICON GRAPHICS: A TURNAROUND?

June-quarter earnings show that it still has some of its old magic

35 ADS FOR GENERATION X

These new spots aimed at hard-bitten kids and young adults push and shove the envelope

38 IS GREG MURPHY TOAST?

Major League Baseball appoints a new chief operating officer, and the marketing czar's future is in doubt

42 IN BUSINESS THIS WEEK

International Business

46 INDIA

Foreign companies see vast market potential on the subcontinent—but many have been tripped up. Here are some lessons for investors

48 COMMENTARY

Bitter medicine is the only medicine in East Asia

57 BRITAIN

The City is getting a financial makeover
Howard Davies

59 INTERNATIONAL OUTLOOK

Hong Kong's pro-democracy activists are bucking Tung's reforms

Economic Analysis

20 ECONOMIC VIEWPOINT

Dornbusch: Why this recovery could go off the track soon

24 ECONOMIC TRENDS

Debunking a stock market crash scenario, violent schools, strong auto sales, incarceration rates

25 BUSINESS OUTLOOK

Consumers have money to burn; employers may feel a pinch soon

Government

43 WASHINGTON OUTLOOK

The GOP could brawl itself out of office unless its factions can compromise



THE BREAKS

Taxes: Who winds up ahead page 30



SPEED SELLS

Suddenly, the auto-racing business is sizzling page 86

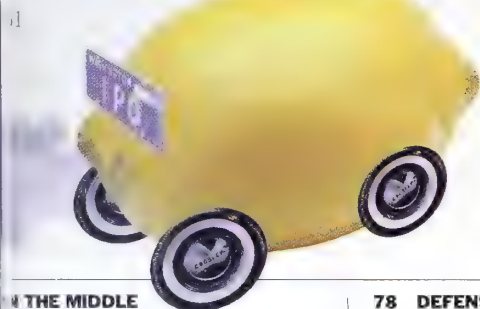


DONORGATE

Meet Ted Sioeng—and his very open wallet page 84

EAL

h in Avis'



INDIA'S PITFALLS

It's a land full of traps for investors page 46

XEROX' BIG HIRE

Thoman will pare and refocus page 81



IN THE MIDDLE
DONORGATE
ed Sioeng a conduit for Chinese
or just an overreaching
preneur?

ertainment

CRAZY ON WALL STREET
ors and banks are lining up to
Hollywood—though they're likely
the last to see any profits

Corporation

PO: BUYER BEWARE
coming rent-a-car offering won't
investors the same dreamy ride
ertz's recent deal did

nce

EBTS, SWEET PROFITS
oased CFS earns eye-popping
as it buys and sells delinquent
card loans

GETTING KICKED AROUND?
m says a Russian client company
ging on millions of dollars it owes
expenses, fees, and equity

- 78 DEFENSE DEALS ARE FAR FROM OVER**
Smaller contractors are linking up like crazy—and many are undervalued
- 80 INSIDE WALL STREET**
- 103 INVESTMENT FIGURES OF THE WEEK**

Information Processing

- 16 TECHNOLOGY & YOU**
Canon unveils a printer that also doubles as a scanner of color pictures and other images
- 81 XEROX' REPAIRMAN?**
Richard Thoman's roll-up-the-sleeves style was widely hailed at IBM. Now, he's taking his act to the copier giant

Sports Business

- 86 THE VROOM IN AUTO RACING**
Superspeedways are springing up as U.S. entrepreneurs tap Wall Street. In Europe, a multibillion-dollar IPO?
- 90 A GAMBLE AS BIG AS TEXAS**
Bruton Smith's Texas Motor Speedway has 150,000 seats, 205 skyboxes—and 76 trackside condos

Science & Technology

- 94 THE FDA: TOO HIGH A THRESHOLD?**
Cephalon wants testing standards eased
- 97 DEVELOPMENTS TO WATCH**
Day care and the Net, snoring, chemical weapons, high-tech metal designs

Personal Business

- 98 ONLINE: Auctions on the Net**
- SMART MONEY: Reverse mortgages**

Features

- 4 UP FRONT**
- 10 READERS REPORT**
- 10 CORRECTIONS & CLARIFICATIONS**
- 11 BOOKS**
Freedman and Mann: *@Large*
- 12 BOOK BRIEF**
- 101 BUSINESS WEEK INDEX**
- 102 INDEX TO COMPANIES**
- 104 EDITORIALS**

The budget deal: A lost opportunity
How to pick the right CEO
Headed for India? Learn the ropes

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Up Front

EDITED BY PAT WECHSLER

LEGAL BEAGLES

URGING THE BAR TO RAISE ITSELF

THE AMERICAN BAR ASSN., AT its annual meeting Aug. 6, is expected to condemn municipal-bond lawyers who contribute to local campaigns in the hope of snagging lucrative business. That's good, says SEC Chairman Arthur

Levitt, muni bond deals after making a campaign gift. But he has run into a roadblock: ABA Ethics Chairman Lawrence J. Fox. A Philadelphia lawyer, Fox says he agrees pay-to-play is bad, but thinks Levitt is overreacting.



LEVITT would curb muni donations

Levitt Jr., but a mere statement doesn't go far enough.

Levitt has been vigorously lobbying for the ABA to prohibit the so-called "pay to play" practice. He would settle for a two-year ban on do-

Both men are active in politics. Fox raised funds to help his brother, Republican Jon D. Fox, win two House elections. Levitt raised more than \$1 million for President Clinton's 1992 campaign, "and that in part is why he appeared on Clinton's radar screen" in his

search for an SEC chairman says Fox. "That is such nonsense," says a Levitt aide. Levitt, he says, had 40 years of Wall Street experience backing his appointment. *Paula Dwyer*

TINSELTOWN

AN ASTRONOMICAL LICENSING DEAL?

WHO WILL THE FORCE BE with? Wall Street analysts and toymakers expect that *Star Wars* creator George Lucas will award the toy license for his upcoming space-action trilogy to Hasbro and Galoob Toys, the makers of the current *Star Wars* toys.

But Mattel's new president, Bruce Stein, may throw a wrench into the works. It was Stein who managed the *Star Wars* toy license for Hasbro until 1994.

At stake: an estimated \$4 billion in



YODA: All ears

sales between 1999 and 2005. Stein has a long shot at bringing home the prize—or a piece of it. Whatever happens, though, he wants to make sure no one gets it too cheaply. Industry sources say Stein talked with Lucas about a 49% equity stake in a new *Star Wars* subsidiary at Mattel, with \$200 million up front.

Hasbro and Galoob, toy-industry analysts say, have countered with offers of \$200 million from each up front and up to 20% royalties on sales. Little Galoob, which will get one third of its expected \$355 million in 1997 revenues from *Star Wars*, is likely to fund this with a big equity stake and cash.

Kathleen Morris

TALK SHOW "After decades of deficits, we have put America's fiscal house in order again."

—President Clinton, on July 29, referring to a new five-year plan to balance the budget



STREET NEWS

NOMURA GUSSIES UP A UNIT FOR AUCTION

JAPAN'S BIGGEST BROKERAGE firm, Nomura Securities International, is taking the first step toward spinning off its successful U.S. commercial real estate division, run by whiz kid Ethan Penner.

Right now, the real estate unit is buried in bureaucracy: It is a mere division of a U.S. subsidiary of a Japanese public company. The plan is to break it out as a stand-alone company that is majority owned by its U.S. parent, Nomura Holding America, with

PENNER will get a stake

its own name. Penner will be joined by Michael Berman, who

resign as NHA's chairman effective Aug. 15 to become real estate division's chairman (NHA's new co-CEOs will be William Wraith IV and sushi Yoshikawa, NHA employees.) The real estate unit could be spun off as an initial public offering. This would allow Nomura to recoup some of the major capital investments it has made in the unit, which did \$6 billion in commercial real estate financing last year. And it would provide an opportunity for Penner, Berman, and other executives who will own a piece of the new stand-alone, to make some money.

In 1996, Penner, 36, collected a cool \$46 million for his work. Says Penner: "This is a better alignment of management incentives with Nomura's." *Leah Nathans Sp*

CHINA RISING

LET 100 MILLION PANTSUITS BLOOM

LOOKS LIKE THE CHINESE are moving from Mao jackets to off-the-rack. China's formerly state-owned enterprises, or "red chip" companies, are showing a particular flair for buying stakes in and setting up joint ventures with Hong Kong clothes retailers.

Most recently, China Resources Enterprises, the Hong Kong subsidiary of state-controlled China Resources Holdings, formed a joint venture with Michael Ying's Esprit Holdings. Ying's company owns a chain of midprice clothing stores in Asia and Europe that use the Esprit name popularized as a U.S. casual-wear chain. The latest deal

would open 100 Esprit outlets in China.

Esprit is not unique. A subsidiary of the State Council's China Everbright IHC, Esprit bought a 20% stake in



BEIJING is buying up chains

Theme International, a Hong Kong fashion retailer for working women.

Analysts predict this is just the start. "Everyone wants the red influence," says Jensen Chow of Hong Kong's ING Barings. The mainland market for casual and upscale clothes, now 100 million people, is growing. And with such Western names as Benetton and the Gap not much of a factor, Hong Kong brands seem poised to dominate. *Bruce Einhorn*

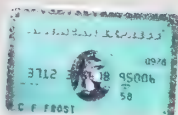
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TINSELTOWN

A WOMAN-HATING MOVIE THAT WOMEN LOVE

WHEN DISTRIBUTORS—MOSTLY male—saw *In the Company of Men* at the Sundance Film Festival last January, their first reaction was that their wives would kill them if they picked up this independent first feature by director Neil



INNER SANCTUM on screen

LaBute. The black comedy, which opens on Aug. 1, follows a business trip of two executives who want revenge on women because both have been dumped by their girlfriends. Their plot is to woo a vulnerable woman—a deaf stenographer at their com-

pany—and then both ditch her abruptly.

Sony Pictures Classics decided to take the counterintuitive approach in marketing: It would aim primarily at women and especially corporate women. First, Sony assigned an all-woman marketing team to make a trailer, design the movie's advertising, and publicize it. Early screenings were filled with professional women to build word of mouth. So far, it has worked. Women, including several critics, are embracing the movie. One viewer described the conspiracy as "real life in the office." Says the film's publicist, Shannon Treusch at Clein & White: "It's like the film opened the door to the men's room and let women inside." Sony's only problem, says Co-President Tom Bernard: How do you sell the movie to men who see too much of themselves in it? □

WEB WARS

CABLE'S STORM KING REINVENTS ITSELF

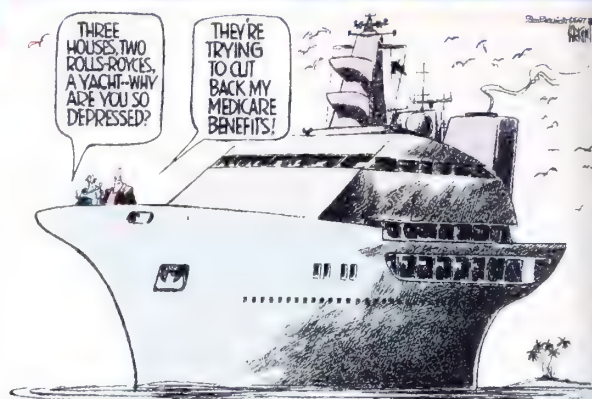
THE WEATHER CHANNEL IS the trailblazer in offering 24-hour coverage of every hurricane and tornado on earth and after 15 years, still has no major rivals on cable. Not so with the Web.

Here, the Atlanta-based forecaster faces more than 2,000 competitors—some of which have outmatched the Weather Channel's daily offerings. Recently, The Weather Channel began to fight back by launching a revamp of its Web site (weather.com). The new site stresses "breaking weather"

coverage and graphics, primarily aimed at besting its major rival CNN (cnn.com). Still, during Hurricane Danny, CNN scooped TWC with photos of wreckage and reports. And despite The Weather Channel's upgrade, CNN's site still has a leg up: downloadable video clips that capture a storm in progress. TWC promises to offer a similar feature by October. Todd Walrath, TWC's director of product development says: "We have a bond with the weather consumer, and the Web helps us reinforce that bond." To alert the consumer about the improved site, TWC is paying its on-air talent some old-fashioned "incentives" to promote weather.com in between forecasts. *Brad Wolverton*



DRAWN & QUARTERED



SPORTS BIZ

THE OLD MEN OF SUMMER SUIT UP

CLOSE TO 400 FORMER PRO baseball players, including such greats as Reggie Jackson, Hank Aaron, and Yogi Berra, are playing hardball again—this time with Major League Baseball's licensing arm.



JACKSON: He's in

Last month, the old-timers signed on to a class action against Major League Baseball Properties.

The suit, which was initially filed last year and was certified as a class action in April, accuses MLB Properties of shortchanging the former players in royalty agreements that compensate them for allowing their names, signa-

tures, and likenesses to be used on everything from videotapes to trading cards. Not everyone, however, wants to be in the game. Two of the plaintiffs opted out, including sports announcer Ralph Kiner, a former Pittsburgh Pirate; Bobby Bruns, former American League president and ex-Yankee; and TV personality Joe Garagiola, a former National League catcher.



But not even all of these men are unsympathetic. "I didn't want it to appear that I was not in support," says ex-Doyle pitcher Carl Erskine. "It was my choice to avoid confrontation." Erskine sits on the board of a Major League-linked group for needy retired players. *Mark Hyman*

GARAGIOLA: He's out

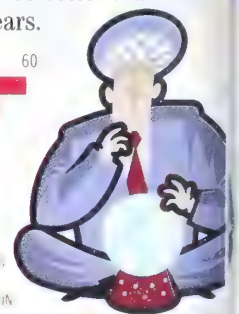
THE BIG PICTURE

BEST BETS ABROAD

U.S. mutual-fund investors with international holdings now number 29%, up from 26% two years ago. Here's what they list as world regions that will be better than the U.S. for investing in the next three years.



DATA: SCUDDER STEVENS & CLARK INC./GALLUP ORGANIZATION





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THE GOOD NEWS FROM SILICON GRAPHICS

It is ironic that "The sad saga of Silicon Graphics" (Cover Story, August 4) hit the stands the day after the company announced the best quarter in its history: well over \$1 billion in revenue and strong profitability.

Most of the story missed the point of where Silicon Graphics is today. Yes, Silicon Graphics has had problems over the past couple of years. We recognized those problems, accepted responsibility, and our management team has been working hard to address them. Very strong actions have been taken, and we are beginning to see the results, as evidenced by our outstanding fourth quarter.

We are very optimistic about this coming year and beyond. This quarter was a reflection of the new Silicon Graphics' ability to execute. Our product transition is complete. We are shipping our entire product line without significant constraints—and most importantly, the new products are finding strong acceptance with our customers. Our entire organization is aligned to build on this success as we enter the new fiscal year.

Never underestimate the creativity and determination of the employees and loyal customers of Silicon Graphics. There is nothing more satisfying to us than to prove the remaining skeptics wrong.

Gary L. Lauer

Executive Vice-President
 Silicon Graphics Inc.
 Mountain View, Calif.

A TIGHTROPE CALLED THE NEW ECONOMY

James C. Cooper's prudent warning about inflation is well taken ("In the New Economy, the old rules still live," News: Analysis & Commentary, July 28). We risk serious trouble if, in boom times, we dismiss the potential threat of an inflated dollar. But for the foreseeable future, inflation is dead. Companies are keeping prices low because of the realities of increased domestic and international competition, a trend that increased

CORRECTIONS & CLARIFICATIONS

"It's not too late to get in on financial merger mania" (Personal Business, July 14) misidentified J. Christopher Flowers. He is a managing director at Goldman, Sachs & Co.

"Smile" (In Business This Week, July 28) misstated Total toothpaste's likely impact on future earnings at Colgate-Palmolive. Analysts expect Total to contribute 4¢ a share to earnings by 1999.

demand in a high-employment economy is unlikely to change.

Furthermore, workers' compensation is no longer just hourly wages. It also includes ownership of stock, medical and retirement benefits, and pay-for-performance plans. This means that the increased outflow of cash to workers is steady but not burdensome, thus enabling corporations to avoid many of the liquidity problems of the past.

I am as reluctant to be an unqualified optimist as I am to be a Cassandra. The new economy merits confidence as much as it demands caution. An undue lurch in either direction could cause the very thing we should most strenuously avoid: the cruellest tax of all: inflation.

Jerry J. Jasinowski

President

National Association of Manufacturers
 Washington

COMPUTER PROFESSIONALS SEEK WORK—AND RESPECT

Neither I nor any of my colleagues who have been through massive corporate downsizings would agree that the labor market for software professionals even remotely resembles that described in your article ("Forget the huddled masses: Send nerds," Information Processing, July 21). Spot shortages of programmers with skills in rapidly expanding fields, such as Java programming, do occur. However, the requirements for these job openings are

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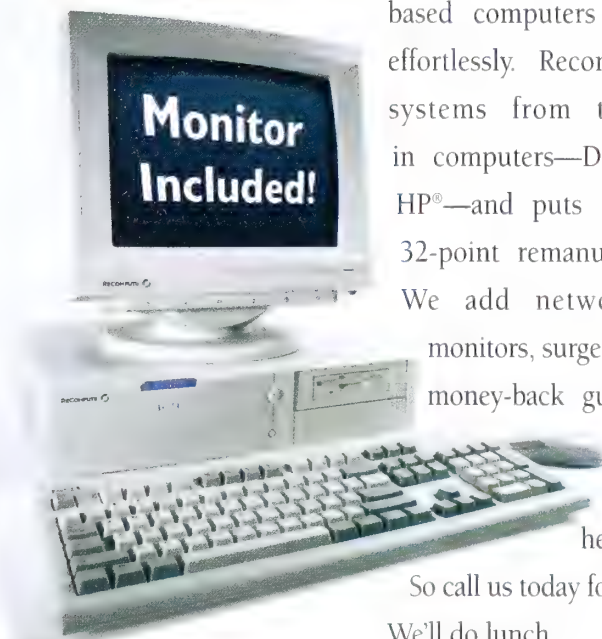
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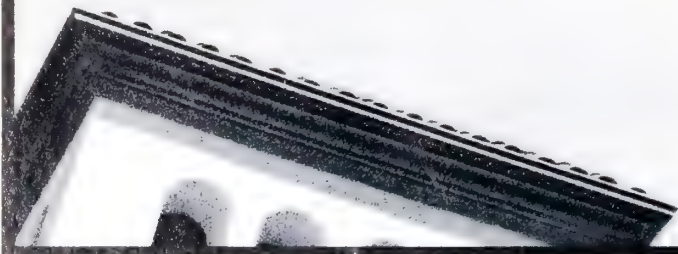
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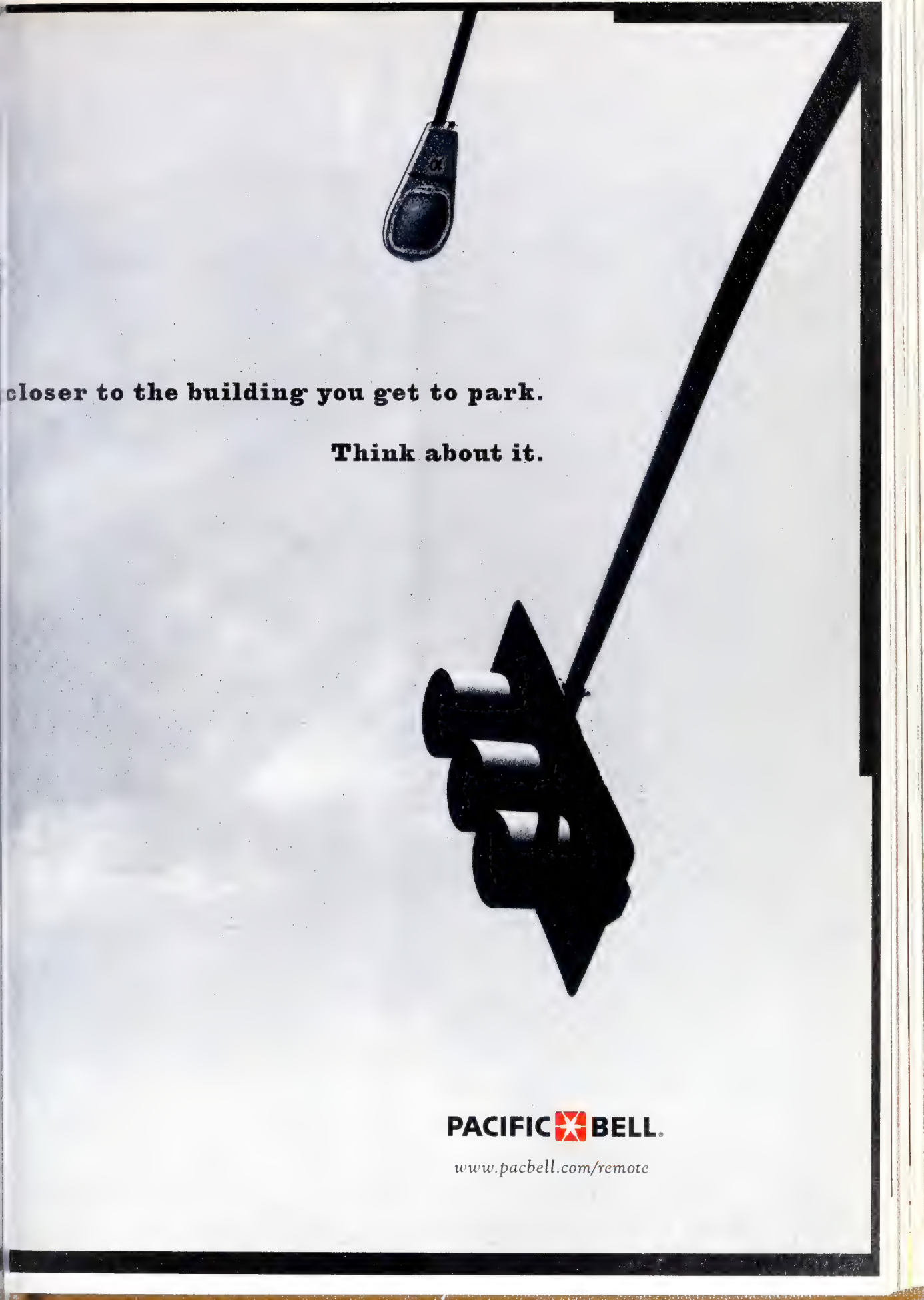
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specific. The "critical shortage of ammeters" described in the article is an indication of the lengths to which companies will go to avoid the associated with training workers.

James Bonang
Los Angeles

Why is it deemed editorially correct in BUSINESS WEEK to use liberally such negative stereotypes as "nerd" and "inept" when referring to computer promoters? According to Webster's, a nerd is "an unstylish, unattractive, or inept person; especially one slavishly devoted to intellectual or academic pursuits." And a geek is "a person of an intellectual bent who is proved of."

Are you bothered to do some investigation, you would find that, lo and behold, there are actually some technical people who aren't socially inept or diserved of!

Chris Toomey
Sunnyvale, Calif.

@LARGE

The Strange Case of the World's Biggest Internet Invasion

By David H. Freedman and Charles C. Mann
Simon & Schuster • 315pp • \$24

A HACKER'S JOYRIDE THROUGH THE NET

A computer network "isn't like a house with windows, doors, and locks," says Open Source Systems Chief Executive and former CIA analyst Robert David Steele. "It's more like a gauze tent encircled by a band of drunk teenagers with lit matches."

Guess what? Some of those kids are packing flamethrowers. From March, 1991, to December, 1992, a hacker known as Phantomd, a.k.a. Phantom Dialer and Infomaster, went on a joyride through the Internet, hijacking computers at the Defense Dept.'s Ballistic Research Laboratory, Massachusetts Institute of Technology, the National Institutes of Health (NIH), and hundreds, perhaps thousands, more. He planted password-grabbing programs on the "backbones" that carry the Net's torrents of data, giving him, in the words of David H. Freedman and Charles C. Mann, "access to everything"—military secrets, corporate data, your E-mail, the works. After a nine-month stakeout in cyberspace, the feds caught the culprit—but, weirdly enough, declined to prosecute.

This cyberfable is the subject of the authors' absorbing page-flipper, *@Large: The Strange Case of the World's Biggest Internet Invasion*. The account focuses on the FBI National Computer Crime Squad's first major probe, and it's an Internet newbie's nightmare. The electronic frontier, as delineated by Freedman and Mann, contributing editors at *Discover* and *The Atlantic Monthly*, respectively, is a borderland too sprawling to police and populated mostly by smash-and-grab artists and easy marks. Internet security is a contradiction in terms: The barricades are so ill-defended that Phantomd, a third-rate door-

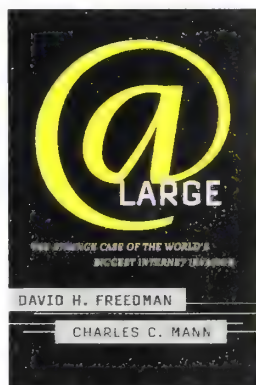
knob-twister, was able to steal an operating system from Sun Microsystems Inc. and tunnel into NASA's computers.

The "world's biggest Internet invasion"—the biggest yet known, it should be noted—drew scant media attention. It was overshadowed by higher-profile types such as Kevin Mitnick, the super-cracker who broke into computer-security guru Tsutomu Shimomura's files. Some of the players in *Takedown*, Shimomura's account of that case, reappear here, but *@Large* is the better book. Its authors

sketch recognizably human beings caught in negotiating the discontinuity between cyberspace and "the so-called real world." One fearsome hacker, for example, is revealed as a school janitor who lives with his parents, while one hackee is likened to "a convenience-store owner who had been robbed a dozen times by the same slow, inept criminal."

The inept criminal, Phantom Dialer, was an outcast even among his fellow nerds of prey. He was dismissed as "a wannabe, a lamer, a poser" on hacker bulletin boards. So pathetic were his attempts to break into systems that they were detected almost immediately. But Phantomd was oblivious to threats from besieged systems administrators, who watched in awe at "the weird, bread-mold tenacity with which he operated." He was like cyber kudzu, a prodigy of persistence who spent hours "typing random combinations of letters in what looked like an attempt to learn Unix [the operating system underlying the Net] by brute force.... Crazy resolute, the cracker managed to get into almost every system he tried."

And what did he want, once inside? Well, nothing really. Behind the melo-



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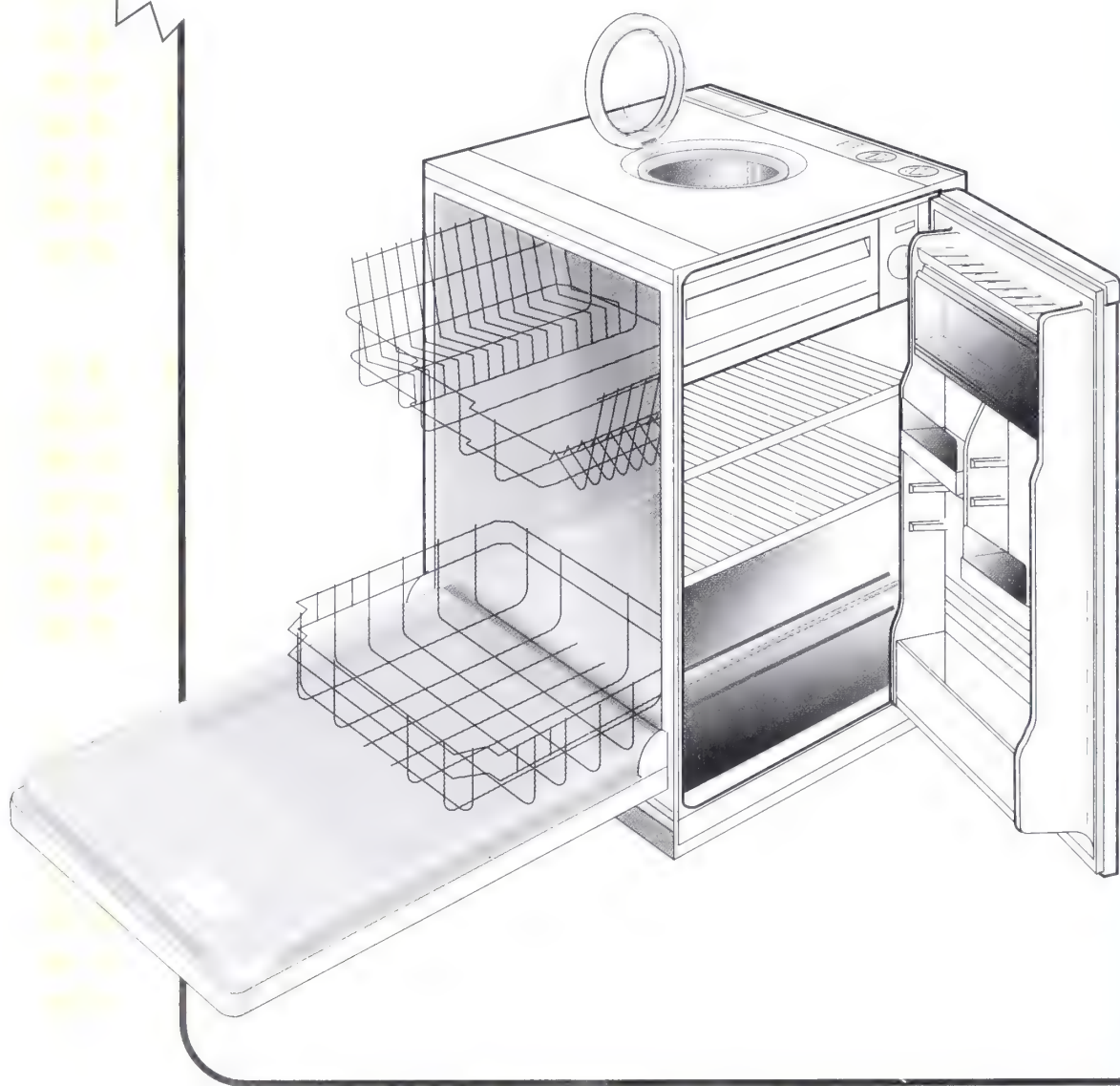
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dramatic Phantom Dialer and Infomaster monikers was a human catalog of infirmities the authors call Matt Singer. (Names were changed at the family's request.) He was variously diagnosed as schizophrenic, mildly retarded, and learning disabled, and he was effectively housebound by bad eyes, asthma, and chronic hepatitis. In one of @Large's odder passages, suggestive of two alien species trying to communicate, Singer is dragged by his brother to Portland State University to confront a computer honcho, Janaka Jayawardene, whose system he had crashed the day before. "Why do you do this?" Janaka asked.... "Why are you breaking into all these systems? What do you want?"

"Access," Matt said.... "I want access." "If we give you an account for free," Janaka said, "an account with total Internet access, will you stop cracking?" Matt turned his face to the wall. "No," he said."

Such a "brain-damaged twenty-year-old" wasn't exactly the Professor Moriarty the Justice Dept. lawyers were looking to build a reputation and a precedent-setting case against, the authors suggest; "He'd last all of fifteen minutes behind bars." So Phantomd remains @large but, one assumes, on a watch list.

Freedman and Mann do a creditable job of hiding the arcana of Internet protocols behind a reader-friendly interface. And where they have no actual computer carnage to report, the authors recount the potential for mayhem in appropriately dropped-jaw style. A break-in at an NIH computer suggests the potential for priceless research to be destroyed and for prescription-tampering at hospitals. When the Bureau of Land Management's dam-control system for Northern California is invaded, an FBI agent realizes that "the Internet was so insecure that some amateur could create one of the biggest calamities in American history by mistake."

If that's not enough to make you want to rip out your modem, the news gets worse. An epilogue notes that where Phantom Dialer had to rely on persistence and dumb luck, mid-1990s vandals have heavier artillery: a hacking-for-dummies suite of point-and-click tools that sniff out network vulnerabilities, snatch passwords, provide other entry points, and erase all tracks. All of these tools are freely available and easily downloaded from the Internet. Where do you want to go today?

BY JIM TAIBI

Assistant Copy Chief Taibi leaves his PC securely unplugged at all times.

BY BUSINESS WEEK WRITERS

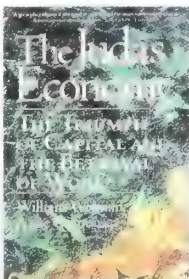
THE JUDAS ECONOMY

The Triumph of Capital and the Betrayal of Work

By William Wolman and Anne Colamosca
Addison-Wesley • 240pp • \$25

BYE-BYE, JOBS?

Workers of the world, be scared. That's the declaration from BUSINESS WEEK Chief Economist William Wolman and journalist Anne Colamosca in their book, *The Judas Economy: The Triumph of Capital and the Betrayal of Work*. In the authors' view, the end of the cold war has allowed capital to fly all over the world and land where labor is cheapest and regulation nil.



Therefore, laborers in the industrialized world will find themselves marginalized by rivals in China, India, and Mexico, who will do their jobs for less.

The authors argue that not even "elite workers"—the highly skilled professionals in the U.S., Europe, Canada, and Japan—can assume that education will save them from a sharp decline in living standards. The problem with knowledge, the authors say, is that it can be taught to anyone. If medical transcribers and computer programmers in Beijing can do the job for one-third of the cost of U.S. workers, then businesses will invest their capital in China.

The authors blame weak governments and strong central banks for industrialized economies' woes. In particular, central banks have kowtowed to global bond markets by stressing price stability over growth.

So, what can the industrialized nations do? Become more productive, the authors say, by using public funds for more education, infrastructure, and research and development. Elite workers must create more and better products than their emerging-nation counterparts if they are to justify the higher salaries and perks that they've grown to expect.

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BY LARRY ARMSTRONG

FOR THIS PRINTER, SCANNING'S A SNAP

With one cartridge change, a \$239 machine turns into a color scanner

Just when I think that color inkjet printers have become pretty much alike in terms of price, print quality, and features, along comes a new one to prove me wrong. For the past couple of weeks, I've been toying around with Canon Inc.'s just-introduced BJC-4304 model, which retails for about \$240. As a printer, it works fine. The major difference is that this printer can also be used as a color scanner for documents, photographs, and other images.

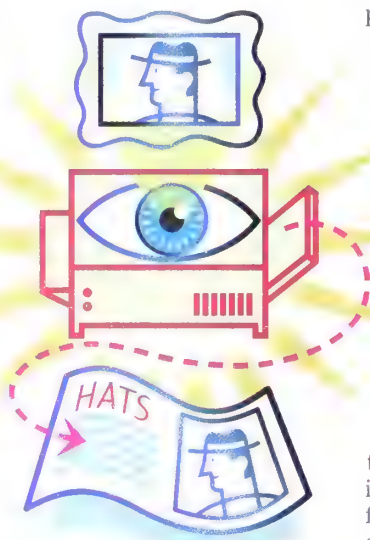
Converting it to a scanner is a snap—literally. Canon has come up with a matchbox-size optical scanner cartridge that snaps into the carrier that usually holds the ink cartridge. The scan cartridge is a \$99 option, but that's about half the cost of other sheetfed scanners.

EASY START. Getting started is simple, too. It involves nothing more than loading the scanner driver software into the computer. You don't have to open the computer to add a board, which many scanners require. You don't have to calibrate colors to match the scanner to your printer, which sometimes can be tricky.

Such a hybrid design does have some limitations, though. After the novelty

wore off, I found it awkward to be continually swapping between the scan cartridge and an ink cartridge to print out the photographs I was scanning in. The swapping also means that it can be inconvenient to use the printer as if were a color copier. Conventional scanners can be set to scan directly to a printer.

But Canon didn't really mean for this to be a serious productivity tool. It only accepts documents one at a time, for example. And it doesn't include any optical character recognition (OCR)



software for converting images of pages into text files that you can edit. (A similar scanner for Canon's upcoming BJC-80 portable printer, popular with students and road warriors, will have it.) Finally, the scanner quality probably won't suit photo enthusiasts who insist on top-quality prints. This machine

is more for the home user who wants to put color pictures in photo albums, school reports, or greeting cards. You could also use it for making digital copies of photos that can be attached to E-mail or posted on Web pages.

FAST WORK. For that kind of casual use, it works extremely well. I scanned 4-in. by 6-in. snapshots in just over four minutes in the 360 dots-per-inch mode. At 180 dpi, it took only a quarter as long. Full-page monochrome scans—which can be used in PC fax programs—took less than a minute. I printed out the images on plain, coated, and high-gloss paper, which took about five minutes each in the printer's highest-resolution mode with a photo ink cartridge. It was hard to tell the difference between the 180- and 360-dpi scans. On high-gloss paper, which costs 50¢ a page, they looked like the original photos.

A few tips. Canon's manual says to always use the scan holder, a clear plastic envelope, to scan things.

Don't bother. I recommend it only when you scan heirloom photos or flimsy, irregularly sized newspaper clips.

I suspect Canon is worried about lawsuits over ruined originals. Also, while Canon says the software provided with the scanning cartridge is an all-purpose photo editor, it can't compress images into the newer, preferred JPEG format, which compresses files to save space on your hard drive. For that you will need to use the ColorDesk Photo software included with the printer.

Given its limitations, this double-duty machine isn't the be-all and end-all as a scanner. But it's enough for what most people want to do. And, most importantly, the price is right.

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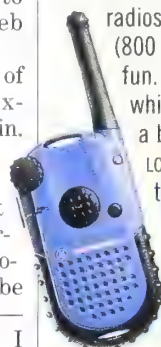
In their brightly colored cases, the new Talk About two-way radios from Motorola Inc. (800 353-2729) look like toys. But these radios, which start at \$149 for a base model with no LCD display, are no toys. Using a piece of the UHF band recently freed for no-license-required family radio service, the

Talk Abouts have a range of up to two miles. That makes them ideal for parents to go off on their own and still keep in touch with the kids while on vacation, at the shopping mall, or at an amusement park. Each Talk About radio is 4½ in. long and weighs 7 oz. Three AA batteries provide enough power for three hours of talk and 2 hours while idle.

MONITORS

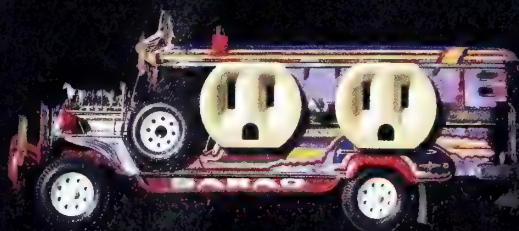
GOODBYE GLARE?

In recent studies, eye doctors report that about 12% of the patients complain of computer-related eye strain. Most recommend that their patients shield computer screens from overhead light and light from adjacent windows. A California company has come up with a practical way to solve the problem. DAP Enterprises (818 786-3295) sells a \$5.99 black cardboard shield that fits 14-, 15-, and 17-inch monitors, depending on where you fold the scores on the cardboard. Adhesive tabs hold it in place. For \$2 more, there's a version for laptop computers.





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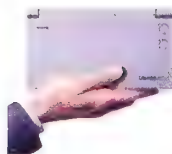
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BY RUDI DORNBUSCH

WHY THIS RECOVERY WON'T FALL OFF THE TRACK SOON



NEW WORLD:
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every boom.
But today's
global economy
is helping to
keep inflation
in check

It feels as if the U.S. economic expansion has gone on far longer and cut far deeper into unemployment than the standards of postwar macroeconomic performance would have suggested. We may well be in a new world in which the traditional economic time limits don't apply. So far, this expansion has more than two years to go to beat the longest, but it still could set a record.

The nine postwar expansions identified by the National Bureau of Economic Research, measured from trough to peak, have averaged 50 months. The longest ones lasted 106 months (in the 1960s) and 91 months (in the 1980s). The present expansion, which started in March, 1991, is in its 77th month.

How much of this expansion is real and will last, and how much is just exuberance and numbers on computers? The stock market is roaring. Consumer confidence is at its highest level in more than a decade and may well reach the postwar high recorded in the 1960s. The good feelings come from sustained growth, record low levels of unemployment, a vast creation of paper and real wealth, a decade without inflation, the most sound budget in 30 years, and relatively peaceful times. Corporate profits have doubled in 10 years, and stocks, even adjusted for inflation, are at their highest levels in history. Median real family income, adjusted with a realistic measure of inflation, is also at its highest recorded level. True, CEOs and blue-collar workers share a sense of insecurity about jobs. But the former have platinum parachutes, while the latter often have their pick of new jobs from which to choose.

UNNATURAL CAUSES. Is all this real? Yes, wealth has been created by massive restructuring of government and business, dramatic innovations in technology and organization, the opening of the world economy, and the lengthening of economic horizons—the payoff from a noninflationary environment. And the absence of inflation is probably the single most important factor. It cost a lot to get to this point—the 1982 recession was the biggest dent in the economy since the Great Depression—but the journey was worth it. The massive restructuring of the U.S. economy could not have occurred without the long and vigorous expansion made possible by lasting low inflation. So, is inflation gone for good?

No postwar recovery has died in bed of old age—the Federal Reserve has murdered

every one of them. The typical pattern, that a few years into a recovery, as unemployment drops and the labor and product markets tighten, wage and price inflation picks up, the wage-price spiral gets moving, and soon the Fed steps in to douse wage demands with a good old-fashioned recession. And the whole cycle starts all over again.

That process has changed in two critical ways. First, companies compete more to win in the world economy: They can produce anywhere, source from anywhere, and face competition everywhere. With goods coming to resemble commodities, manufacturers are pressured by customers for the best prices and stockholders for the best results.

Those pressures push down into the labor market. Workers can be made redundant. In the past, they were laid off in a recession, then recalled as recoveries began. A moment of wage discipline would occur, and then, with the upswing, pay packets would quickly cover. Today, employment in an individual company depends far more on the global competitive position of the plant than on the U.S. cyclical position. So good economic times do not remove the pressure for companies to perform, or the insecurity of their workers. **STICK AROUND.** Second, we no longer have unions that organize cyclical raiding parties on corporate profits. They are largely gone, having shifted their focus to jobs and away from wages. As a result, the U.S. business cycle has gained far more room to grow. Without wage inflation that's passed on to the product market, the economy can go much further toward reaching full employment.

So we have a high-pressure economy in two ways: high pressure of demand, which creates jobs for more and more people, and high pressure of competition, which combines higher output with cost control. We can shrug off the fact that there is such a thing as full employment—even though we may not be sure at what jobless rate full employment has been reached. But unlike during the last expansion of the 1960s, we have the external factor of global competition, and hence cannot expect to do a better job of keeping inflation under control than we did then.

The Fed can shut off growth and prosperity in no time. But don't worry, Fed Chairman Alan Greenspan is a great host. He won't move the refreshments until inflation troubles really start. The boom is far from over.

Rudi Dornbusch is professor of economics and management at Massachusetts Institute of Technology



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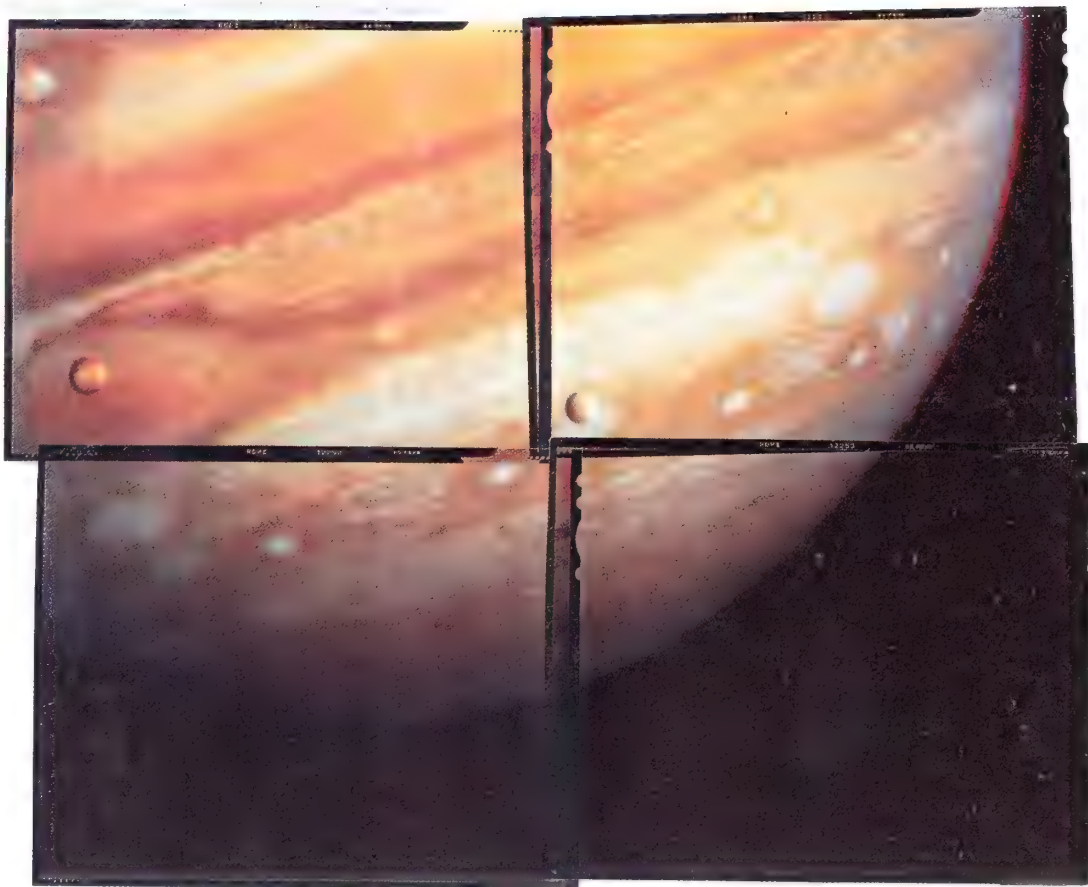
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BY GENE KORETZ

DEBUNKING A CRASH SCENARIO

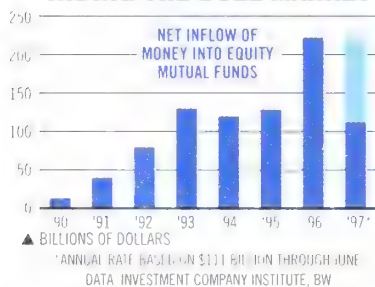
Could fund outflows sink stocks?

The stock market vaults ever higher, and cash continues to pour into equity mutual funds. It doesn't take a genius to figure out that these trends may be connected. And therein, notes a study in the Federal Reserve Bank of New York's current *Economic Policy Review*, lies the basis of a recurrent nightmare haunting Wall Street.

For, as authors Eli M. Remolona, Paul Kleiman, and Debbie Gruenstein point out, if surging stock prices are sparking strong mutual-fund inflows that tend to push up prices even more, then it's possible that a sharp drop in prices could reverse the process, setting off a cascade of redemptions by fund investors that could escalate into a market crash. To assess the likelihood of such a scenario, the researchers review the historical record—and particularly the influence of short-term shifts in stock prices on fund flows.

The study comes up with several reassuring omens. One is that directly owned stock funds represent only 5.5% or so of household financial assets (an ad-

EQUITY FUNDS ARE RIDING THE BULL MARKET



ditional 2.4% is held in pension plans, which tend to take a long view of stock market performance). Moreover, over half of equity-fund assets are held in funds charging an up-front sales fee, and such "loads" inhibit short-run selling. And since mutual funds still account for only 14.9% of equity market capitalization, outflows alone seem unlikely to cause a sharp market decline.

But the key question is whether sudden shifts in market returns significantly affect fund flows. And here the economists' statistical analysis of data from

1986 through early 1996 indicates that the impact is extremely weak. Further, they find that funds investing in growth stocks, which usually lead the pack in market swings, are less sensitive to price shifts than income funds, suggesting that growth fund investors aren't spooked by price volatility.

What of the big market declines in October, 1987, and October, 1989? In the first, as growth stock prices plunged by an average 37.7%, net outflows from growth funds hit 4.6% of assets, compared with average fund liquidity levels of 9.4%. In the second, growth stocks fell by 6.2% and growth funds suffered outflows of just 1.3% of assets.

"At least up to now," says Remolona, "the evidence suggests that the impact of stock-price movements on equity-fund flows is not strong enough to sustain a downward market spiral."

THE CLASS OF BOXCUTTER HIGH

Violent schools mean fewer grads

Studies of the effect of school characteristics on students' educational progress have traditionally focused on such things as class size, per-pupil expenditures, and teacher education. In a new research paper, economist Jeffrey Grogger of the University of California at Los Angeles looks at a factor that has received relatively little attention: school violence.

Using nationwide public high school survey data from the 1980s, Grogger finds that minor levels of violence—a problem faced by nearly two-thirds of public school students—lowered the chances of students' graduating from high school by about a percentage point to 78% and their chance of going to a four-year college by four percentage points to 27%. And moderate levels of violence (faced by 9% of students in the sample) reduced the likelihood of high school graduation by about 5 percentage points and of college attendance by 7 percentage points. The effects of serious violence were even greater.

It's no secret that school violence can impede education in a variety of ways—by disrupting classrooms, for example, or causing students who fear attack at school to stay at home and risk falling behind, or interfering with student concentration. Grogger's findings underscore the negative impact on students' future educational attainment and thus on their lifetime earnings potential.

STILL NO GLUT OF NEW WHEELS

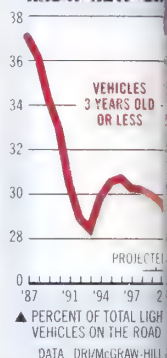
U. S. auto sales should stay strong

With sales of new cars and light vehicles averaging close to 15 million units a year in recent years, some experts think the U.S. new market is finally approaching saturation and an inevitable downturn lies ahead.

Not analysts at DRI/McGraw Hill, who predict sales will escalate from 15.2 million units this year to a 15.5 million-unit clip from 1998 through 2001. For one thing, DRI economist Ezra Greenberg points out that relatively new cars (three years old or less) currently account for about 30.3% of vehicles on the road. That's significantly below the 37% peak reached a decade ago (chart).

Moreover, notes Greenberg, even the wake of strong sales since 1994, a share of such nearly new vehicles has started slipping recently. And despite the 15.5 million-unit sales pace that is seen ahead, it expects the percentage of vehicles in the three-years-old-or-less age group to ease down to 29% by 21

NOT EVERYONE HAS A 'NEW' CAR



DOING TIME IN THE USA

It's in the cards for 5% of Americans

What are the odds of an American born today winding up in prison sometime during his or her lifetime? According to a Justice Dept. study based on 1991 incarceration rates in federal and state prisons, the answer is about one in twenty or 5.1%.

The risks of jail time are greater for men than for women (9% vs. 1.1%) and particularly high for black and Hispanic men: 28.5% and 16% vs. 4.4% for white men. These odds are undoubtedly understated, since the study doesn't include the likelihood of being incarcerated in a local jail or juvenile facility, or the annual rate of admissions to local jails is nearly 30 times the pace of admissions to state and federal prisons.

JAMES C. COOPER & KATHLEEN MADIGAN

HIGHER WAGES GIVE CONSUMERS MONEY TO BURN

Ever-tighter labor markets may start to squeeze profit margins

U.S. ECONOMY

A week before the July 29 report on labor costs, Federal Reserve Chairman Alan Greenspan told Congress: "Increases in the employment cost index still trail behind previous relationships to tight labor markets I have suggested." Well, after the latest report, it's still true. For now, the bottom lines of business and households are all the better for it, but the future still demands caution.

Higher labor costs are not only good news for inflation and interest rates. They also suggest that corporate profit margins are not under any great pressure. However, with inflation already so submissive, workers are enjoying increases in their real wages, a key reason why second-half consumer spending is set to rebound from the second-quarter slowdown. That exuberant power, amid abundant employment opportunities, also explains why household attitudes remain upbeat (charts), and why housing is likely to rebound later this summer.

The second-quarter employment cost index (ECI) for private-sector workers rose 0.8% from the first quarter, a slight acceleration from the first-quarter increase of 0.6%. Over the year, however, the cost of wages and benefits last quarter inched up only 2.9%, the same annual pace as in each of the previous four quarters.

As for profits, productivity growth through the first quarter appears to have offset much of the rise in labor costs. That means unit labor costs grew slower than prices, a precondition for rising profit margins. Of course, for that pattern to continue in the second half, employment costs will have to stay flat, and productivity must stay up.

THE SECOND-QUARTER ECI offers hope on the front, history suggests that the way from here will not be easy. First, productivity growth typically slows as labor markets approach "full employment," since the least productive workers are the only ones left to hire. It would appear that second-quarter productivity was weak, given that real gross domestic product and hours worked appear to have grown at only similar rates. And second, amid such tight labor

markets, there is no guarantee that employment costs will remain as tame as they have, especially with the wage component of the ECI already creeping up.

Straight pay from wages and salaries rose 0.9%, the same as in the first quarter. But in the first half of 1997, wages increased at a 3.6% annual rate, up from 3.4% for all of 1996 and 2.8% in 1995. That acceleration is consistent with what most economic models would predict, given that the jobless rate has fallen to only 5% or less.

However, slow growth in employee benefits continues to offset faster wage growth, holding down overall costs. Benefits rose 0.7% last quarter, after almost no growth in the first quarter. Businesses have profited from the mild growth of benefits. Indeed, it was the cost containment in benefits from 1993 until early 1996 that caused almost all the slowdown in total compensation.

That downtrend, though, may go into reverse, and health care is a big reason why. In the 1990s, the slowdown in medical-insurance premiums trimmed the growth in overall bennies. Companies squeezed costs by pushing workers into health-maintenance organizations or bargaining with hospitals for discounts. But those cost-cutting methods are about played out, as suggested by the second-quarter speedup in the medical-care component of the consumer price index. So unless they drop health insurance altogether, businesses are likely to face rising premiums in the future.

Moreover, many employee benefits—including paid vacations, pension contributions, and holiday pay—are tied to wages. So as salaries rise, so will the cost of benefits.

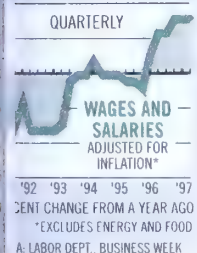
THE GOOD NEWS FOR WORKERS is that even as benefits have held down overall employment costs, the upward creep in wages, combined with declining inflation, have generated the fastest annual growth in real wages since 1983. Using the wage component of the ECI and the core consumer price index, which excludes the ups and downs of energy and food that can distort inflation's underlying trend, real wages in the second quarter were up 0.8% from a year ago. Before early 1996, this measure of real wages had not risen in ten years.

Rising purchasing power helps explain the cheery

JULY OPTIMISM DIPS, BUT REMAINS HIGH



WORKERS ARE SEEING REAL WAGE GAINS



mood of consumers. The Conference Board's index of consumer confidence slipped to 126.5 in July, but that's coming off of a 28-year high of 129.9 in June.

The index covering consumers' assessments of the economy's present condition and the measure of expectations for the next six months each fell a bit in July from June's very high levels. However, consumers remained convinced that labor markets are tight. The board said 36% of consumers thought jobs were plentiful in July, the same high percentage as in June, which was the most since 1969.

MORE BUYING POWER and confidence about the future are always key ingredients in a healthy outlook for housing. Throw in the recent fall in mortgage rates, and it is easy to see why housing will perform better this quarter than it did in the second.

Sales of new single-family homes rose 6.1% in June, to an annual rate of 819,000. Sales for the second quarter averaged 785,000 per month, down from the nearly 20-year high of 824,000 hit in the first quarter, although that level was probably exaggerated by the government's new data-collection method. Thanks to the summer bond rally, however, housing demand picked up considerably heading into the third quarter and builders' inventories are already low.

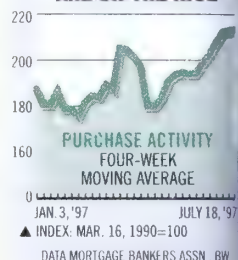
The average 30-year fixed mortgage rate slipped to 7.65% in mid-July, from 8.3% in early April. As a

result, house hunters are making offers, and homeowners are flocking to refinance existing loans. The four-week average of mortgage applications for home purchases is running at their highest pace since Mortgage Bankers Assn. started keeping records in 1990 (chart). Given the lag between applications and closings, those loan requests should show up as increased home sales in August and September.

Low rates also have touched off another round of refi madness. Refinancing applications in the week ended July 18 were double their pace of April. That refi money is likely to join income growth as additional fuel for consumer spending.

For now, overall labor costs continue to defy those past relationships that Greenspan discussed. And rising profit margins, high readings of confidence, and the spread of home ownership suggest that businesses and consumers are sharing the benefits. The danger is that rising real wages could propel stronger-than-expected consumer-led demand in the second half. If so, look for a further tightening in the labor markets and bigger additions to wage growth.

MORTGAGE APPLICATIONS ARE ON THE RISE



BRITAIN

ROBUST GROWTH SETS UP A POLICY DILEMMA

The British economy has chalked up another quarter of robust growth. Real gross domestic product grew 0.9% in the second quarter from the first, and it is up a solid 3.4% from year-ago levels. However, that pace is well above the Treasury's 2.25% estimate of the economy's maximum noninflationary trend rate, putting policymakers in a bind.

That's because growth is uneven, reflecting the strong British pound. Domestic demand for business and financial services and communications led the second-quarter rise, and consumer spending was very strong. Real retail sales grew at an annual rate of 7.2% last quarter. Household

spending is being fueled in part by stronger labor markets. The number of unemployed fell by a substantial 36,500 in June.

Manufacturing, however, is struggling. Industrial production, down 0.9% in May, is growing roughly similar to its year-ago pace, as a strong sterling hammers exports. Low inflation, a strong economy, and rising interest rates have lifted the trade-weighted pound by 25% over the past year, and exports

have fallen in five out of the last seven months. The Confederation of British Industry's quarterly survey showed that export orders in the second quarter fell by the largest amount in six years. The

plunge, along with prospects for higher interest rates, brought down the overall business confidence index by six points.

The pound should strengthen further as the Bank of England hikes rates to head off inflation. The newly independent BOE has lifted base rates three times in as many months, including a quarter-point hike in July. The dilemma for policymakers: how to blunt inflation without killing manufacturing. "What we have is very bubbly consumer demand and house-price inflation which is little affected by a high exchange rate," says BOE Deputy Governor Howard Davies.

But with the consensus forecast expecting robust GDP growth of 3.2% in the second half, and with inflation already drifting above the Treasury's target rate of 2.5% further hikes seem likely.

BRITAIN'S ECONOMY LOOKS MUCH STRONGER



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WITH GOODIES FOR ALL

The budget deal erases the deficit, but only for as long as the economy booms

Only in Washington could anyone promise to balance a budget by raising spending and cutting taxes. And only in this economic cycle of strong growth and low inflation could it work.

That, in essence, is the story of the Great Balanced Budget Agreement of 1997. This is not to say the deal is fake. Indeed, not only will the budget come into balance by 2002, but the deficit could disappear as early as next year—so long as growth remains robust.

But even the buoyant U.S. economy won't solve the problems that Washington took a pass on this time around—an overhaul of Medicare, the federal health program; and Social Security. Unless Washington follows through with major reforms in these entitlements and looks for other domestic spending cuts, the budget won't stay in balance for more than a year or two.

Alas, when President Clinton and congressional Republicans announced their deal on July 29, such grim undertakings were the last things on their minds. Instead, they jubilantly dispensed tax and spending goodies to the many and called for sacrifice from the few.

Indeed, the budget deal came together so easily after years of partisan fighting only because it contained so many gifts—and ducked so many hard choices. "It's Santa Claus in July," grouses Senator Ernest F. Hollings (D-S.C.), a longtime deficit hawk. Adds David H. Resler, chief economist of Nomura Securities International Inc.: "I'd love to negotiate with these guys. Their idea of compromise is to say, 'If you give me more, I'll give you more.'"

QUICK TURN? The pols can be so generous only because the economy keeps outperforming expectations. If that continues and the economy grows 3% a year—about half a percentage point higher than Administration forecasts—Washington could have \$100 billion in 2002 for still more tax cuts or spending. On the other hand, the economy could slip into recession during the next five years. A '98 downturn would quickly turn the 2002 balanced budget into a deficit approaching \$75 billion.

That's how the overall economy will make or break the budget. But how will the budget pact affect growth? The GOP insists that slashing capital-gains tax rates and expanding individual retire-

ment accounts will spur investment and growth. Clinton argues that education incentives will do the same. And both sides insist that fiscal balance alone will produce a big payoff.

But mainstream economists are underwhelmed. They figure that most of the interest-rate benefit of shrinking federal deficits has been priced into markets. The deficit has been falling for five years, and this deal had been expected. Although the benchmark 30-year Treasury bond fell to 6.33% on July 29, Roger E. Brinner, chief economist DRI/McGraw Hill, expects rates to fall more than another half-point.

For a longer-term impact, many economists and business leaders still look for action on entitlements. Medicare, which got trimmed by \$115 billion in the deal, still needs major reform to keep it solvent once baby boomers begin retiring. And the pact didn't even touch Social Security. "These issues must be dealt with," says ConAgra Inc. Chairman Philip B. Fletcher. "If you do find a way through in this kind of booming economy, politicians will just play their same games later."

In this deal there were some losers. Smokers and some airline travelers face higher taxes. Seniors will see fast increases in Medicare premiums, and Medicare payments to doctors are

hospitals will rise more slowly.

But there are far more winners. Savers, investors, and families with children get sweet new tax breaks (page 30). Broadcasters will get billions' worth of public airwaves for free. Tobacco growers will continue to get millions in crop insurance. And colleges will get new construction subsidies. "Spending increases too much," complains Representative Matt Salmon (R-Ariz.).

In total, outlays will grow from \$1.63 trillion this year to more than \$1.8 trillion in 2002. Over the next five years, the government will spend \$275 billion less than it would have without a deal. But 85% of those savings won't come until 2000 or later. And half will come from future cuts in domestic programs.

Taxes will be slashed by \$94 billion over the next five years, partly from the capital-gains cut that delights investors and entrepreneurs with big paper gains. "It's not a trickle-down effect," says Cisco Systems CEO John T. Chambers. "It's a waterfall."

But another high-tech chieftain worries about the overall size of the tax bill. "Cutting taxes now is a little short-sighted," says James H. Clarke, Netscape Communications Corp.'s chief executive. In fact, over the next decade, the cuts will divert more than \$250 billion from the treasury, putting more pressure on the budget just when spending on seniors is expected to take off.

Even some conservatives doubt that cutting capital gains will encourage long-term investment. They are even more skeptical about the \$500 child credit and the education tax breaks. "It's stupid tax policy," says Resler. "This takes a tax code that didn't make a great deal of sense and makes it even worse."

In the end, the Administration and Hill Republicans will claim credit for budget balance—despite their tax cuts and spending deals. But the vast bulk of deficit reduction came between 1992, when the deficit hit a record \$290 billion, and this year, when it could fall as low as \$25 billion. The biggest single reason: the cold war's end. Defense spending fell from 6.4% of gross domestic product a decade ago to 3.4% now. Adjusted for inflation, the 1997 military

OUT OF BALANCE?

Efforts to balance the budget have taken a back seat to tax cuts and spending hikes.

TAXES Would be cut by \$94 billion over five years, and \$250 billion over 10. Investors, families with children, and heirs to large estates are big winners. Much of the cut will be paid for by extending the tax on airline tickets.

MEDICARE Unwilling to make many fundamental changes in the program, Congress and the President agreed only to trim payments to doctors, hospitals and HMOs by \$115 billion over five years.

CHILD HEALTH Budgeteers talked about curbing entitlements but wound up creating a new one: guaranteed health care for 5 million low-income kids ineligible for Medicaid.

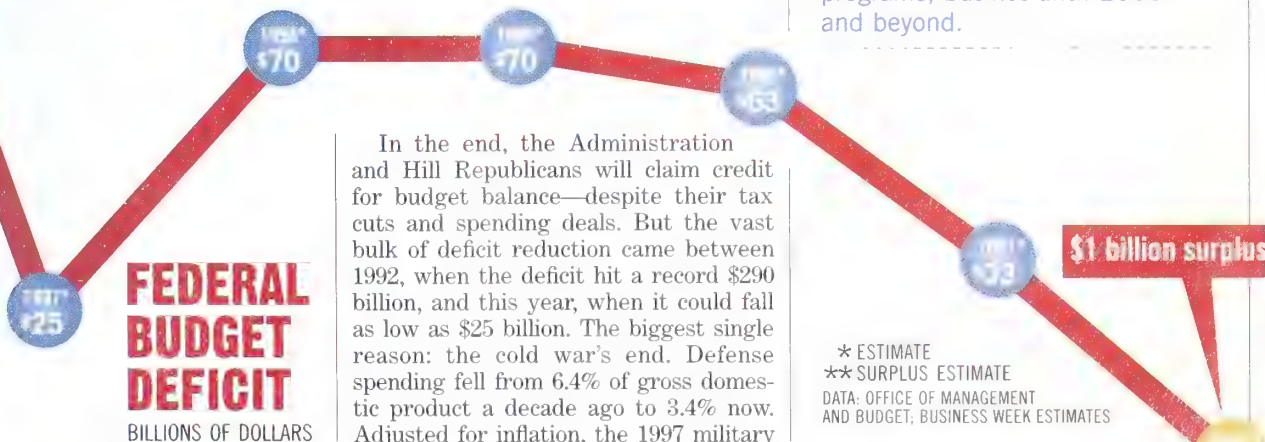
CORPORATE WELFARE

Lawmakers failed to get rid of any big tax and spending giveaways. They added some. Among the biggest: TV stations will get free use of an additional \$5 billion in public airwaves.

DOMESTIC SPENDING It will actually go up a bit in the coming fiscal year. The deal promises cuts in the growth of domestic programs, but not until 2000 and beyond.

FEDERAL BUDGET DEFICIT

BILLIONS OF DOLLARS



budget is \$100 billion less than in 1987.

The rest of the credit goes to two of the most maligned budgets in recent memory—George Bush's "Read My Lips" plan in 1990 and Clinton's 1993 fiscal blueprint. Bush pushed through a tax hike and arcane budget rules that froze most spending—except for Social Security and Medicare. Clinton followed with a tax increase of his own and continued the spending restraint. As a result, Washington has slashed cumulative deficits by \$2 trillion since 1990. The new deal would cut the last \$200 billion. Says Budget Director Franklin D. Raines: "We're just doing cleanup."

It's not even a messy job. Apart from Medicare, there aren't many spending cuts. Indeed, many programs will grow. House Minority Whip David E. Bonior (D-Mich.), a liberal firebrand, backs the deal because it expands the entitlement to medical care to 5 million low-income kids. "It's the largest health-care bill for children in 35 years," he brags.

TV broadcasters, who gave more than \$4 million in the 1996 congressional elections, love the deal, too. They get free use of an extra channel for the next decade—a gift worth about \$5 billion. Tobacco interests get a goodie to help offset a 15¢-a-pack hike in cigarette taxes: The budget retains a crop-insurance program worth \$34 million a year to tobacco farmers. "There's something in this for everybody," says Cato Institute budget analyst Steven Moore.

NEW CHANCES. But despite the pork, the news isn't bad. What really matters is that, after 20 years of fighting, Washington has managed to get a budget that balances. Michael J. Durham, CEO of Sabre Group, an information-technology unit of AMR Corp., praises the pact: "It's a very significant step in reducing uncertainty and volatility. We should applaud our politicians."

Don't count on that. For now, the deal ends Washington's obsession with the deficit. That gives lawmakers the chance to move on to new domestic policy fights: repairing Medicare and Social Security and restructuring the tax system. Those disputes will be just as contentious as the battle of the budget.

Or worse. While the strong economy made the final round of budget-cutting a breeze, the pols may not be so lucky when they get around to the entitlements. The retirement of the boomers is one problem America can't grow its way out of. The tough choices still lie ahead.

By Howard Gleckman, with Amy Borrus and Mike McNamee in Washington and bureau reports



CAPITAL GAINS: The new deal may be a boon for growth stocks

THE TAX DEAL: AND THE BIG WINNERS ARE..

For years, Republicans have stumped for a thorough overhaul of the tax code. But given their first chance in 16 years to cut taxes, they're delivering nothing more than a tune-up. The message for taxpayers: Use the new tax-cut bill to tweak the family finances but don't worry about radically restructuring investments or estate plans.

For starters, the biggest benefits in the \$94 billion, five-year tax cut involve activities that aren't much affected by tax planning. Parents in most income brackets will snag a \$400-per-child tax credit next year, rising to \$500 in 1999. College students and their parents can reap up to \$1,500 in tax credits to help pay for tuition. Homeowners will get some relief from both taxes and paperwork: The bill will exempt up to \$500,000 in home-sale profits from tax.

SMOKERS WILL FUME. But tax-savvy households will need to review their financial plans to take the best advantage of the new bill's provisions (table). Investors will enjoy a substantial cut in capital-gains taxes paid on profits from the sale of stocks and other assets. Savers will get new tax-exempt accounts for college tuition and retire-

ment. And estate planning will get a boost—especially for small-business owners and farmers. They'll enjoy an immediate doubling of the amount they can shelter free of estate and gift taxes to \$1.3 million.

With the GOP and President Clinton targeting relief to individual taxpayers, corporate taxes weren't changed much by the deal. But House Republicans want a major cutback in the hated Alternative

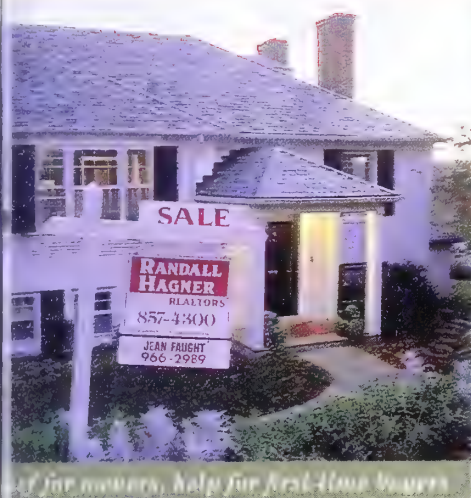
Calculating Your New Tax Bill

CAPITAL GAINS

The top tax rate on profits from the sale of assets will be cut to 20%, if an asset is held 12 months (up from one year under current law). This will boost growth stocks and high-tech investments that pay interest and dividends.

Minimum Tax, a parallel code designed to ensure that all profitable companies pay up at least some share of the tax bill to the Internal Revenue Service. The AMT will be abolished for small businesses with gross receipts of less than \$5 million—roughly 90% of all incorporated businesses. Bigger companies will get an effective exemption from the minimum tax's added paperwork.

Who loses? Smokers will shell out another dime a pack in federal taxes in 2000 and an additional nickel come



CHILD CARE: Parents get credits for day care and their education.

al filers and those who take will pay a bigger share of ed \$33 billion air-travel ticket .5% tax will apply for the to credit-card companies that ent-flier miles to award cus- some companies have been t as part of \$10 billion in closers."

st individuals, the biggest the cut in the capital-gains tax will fall from its current ate to 20% for joint filers re- ore than \$41,200 in income. To at that rate, though, assets eld longer—18 months, up onths under current law. (As- etween May 7 and July 28, enjoy both the 20% rate and ear holding period.) The rate

rent income, taxed at rates up to 39.6%, in favor of those that yield capital gains. That's bad news for bonds and utilities but a boost for small-cap and growth stocks.

Individual retirement accounts will also get a new lease on life. The agree- ment would double the income limit for deducting IRA contributions by 2007, to \$80,000 for couples and \$50,000 for single filers. The bill also creates a new "backloaded" IRA, called "IRA Plus." Deposits in the new plan aren't de- ductible, but earnings are never taxed if withdrawals are postponed until retirement. These accounts will be available to single taxpayers earning up to \$95,000 and couples earning as much as \$150,000.

Another bennie: First-time homebuy-

will shun, while their luster as savings vehicles will be dulled by more generous IRA rules. Mutual funds, on the other hand, will ride even higher: Funds now hold 38% of IRA assets—a larger share than brokerages command—and could get more as IRAs expand.

NEW ESTATE PLANS. Investors will want to pay more attention to "asset place- ment," notes Joel M. Dickson, an in- vestment analyst for Vanguard Group. Income-producing investments, like bonds, should be held in tax-favored ac- counts such as 401(k)s and IRAs. Growth-oriented investments should be held outside IRAs, so they'll enjoy the lower capital-gains tax rate.

Families should also review their es- tate planning. By 2007, estates of \$1 million can be passed on without facing

TAX

empt portion of ll gradually be om \$600,000 to 1. Heirs of small- owners and farm- immediate \$1.3 exemption and can it payments.

% in 2006 for assets bought in ter and held five years. mediate result: Many in- ay sell stocks they've been unload once the tax bill hat could push the market fly—but "most of that money right back into stocks," pre- k M. Zandi, chief economist al Financial Associates Inc., a ster (Pa.) economic forecasting lting firm. Longer term, in- ill shun holdings that pay cur-

PARENTS' BREAKS

Most couples earning up to \$110,000 will get a \$400- per-child credit in 1998, rising to \$500 in 1999. College tuition: a credit of \$1,500 in the first two years, dropping to \$1,000 in later years.

ers can withdraw funds for a downpay- ment from their IRAs or those of their parents or grandparents without penal- ty. And the bill lets parents put \$500 a year per child in education accounts that function like the backloaded IRAs and with the same income caps.

Combined with the lower capital-gains rate, the new IRA provisions should lead some investors to rethink their invest- ment strategy. Variable annuities could be doubly hurt. These instruments pay out ordinary income, which investors

SAVINGS PLANS

Couples with incomes up to \$150,000 can put up to \$4,000 a year into new "IRA Plus" and up to \$500 per child into education accounts. Deposits aren't tax-deductible, but earnings are tax-exempt.

MINIMUM TAX

The Alternative Minimum Tax is eliminated for small companies and eased for other businesses. But more individuals may be subject to the AMT, wiping out some advantages of their lower capital-gains rate.

the estate tax, up from today's \$600,000 limit. (The exemption for family-owned businesses and farms rises to \$1.3 mil- lion in 1998 and stays there.) So there's one group that's sure to get a boost from the new tax bill: the accountants, lawyers, and planners who thrive on complexity in the tax code. Says John H. Gardner, of accountants KPMG Peat Marwick, with a grin: "Change is al- ways good for us."

By Mike McNamee in Washington, with Jeffrey M. Laderman in New York

HEALTH CARE

GUESS WHO'S IN THE WAITING ROOM

The feds widen their crackdown on Medicare overbilling

The letter from the Justice Dept. shocked President James W. Varnum of Mary Hitchcock Memorial Hospital. Alleging that his Lebanon (N.H.) hospital committed fraud in the way it billed Medicare in the early 1990s, the feds demanded \$1 million in their January letter, mostly in civil fraud penalties. Varnum says that the overpayments resulted from a mistake-prone billing system. Still, in May, rather than litigate, he settled with Justice by paying \$100,000. "Whenever there is any error, the government says it's fraud and abuse," Varnum fumes. "It's not right."

Health-care providers such as Varnum had better get used to it. In the past 10 months, Justice and the Inspector General of the Health & Human Services Dept. recouped \$1.1 billion from Medicare providers, compared with \$250 million collected over the previous 12 months.

MORE GUMSHOES. That's just the beginning. A new report by the HHS inspector general gives investigators a huge new target: an estimated \$23 billion in Medicare overpayments—through fraud or error. On July 28, HHS released another audit in which analysts estimate that 40% of all home health-care payments by Medicare may be unjustified. Two days later, a federal grand jury unsealed indictments against three Columbia/HCA Healthcare Corp. executives as part of a sweeping probe of the chain. They're accused of filing inflated Medicare billings that led to \$1.8 million in overpayments to one hospital.

Expect more of the same. Congress

has increased funding for health-care investigators. And thanks to new and more sophisticated auditing systems, the probers are finding it easier to spot unusual billing patterns. Health-care probes by the Federal Bureau of Investigation, meanwhile, are rising fast—2,300 in the first half

GROWING CLAIMS: The feds face a mountain of paper



THE MEDICARE MONEY TRAIL

HOSPITALS Federal investigators are probing 4,600 hospitals for possible violation of a Medicare rule barring hospitals from submitting bills for outpatient services if the patient is admitted for inpatient care within three days. Feds also investigate 33 teaching hospitals for billing Medicare for attending-physician fees when residents perform services.

CLINICAL LABS "Labscam," a multiyear probe, netted \$830 million. Abuses included running specimens through equipment that performs numerous tests simultaneously, then billing Medicare separately for each test. In February, SmithKline Beecham Clinical Laboratories settled with the feds for \$325 million.

HOME HEALTH CARE Federal investigators estimate 40% of the \$16.9 billion spent on home health care under Medicare is unnecessary. Medicare places no limits on home health-aide visits, and regulators don't check backgrounds of home-care agency operators.

of 1997, up from 591 in all of 1992.

One huge target is home health care. Since 1990, annual Medicare payments to home-care agencies have quintupled, to \$16.9 billion. Regulators don't check the backgrounds of home-care agency operators, and Medicare allows unlimited home health-aide visits. "People are

seeing it as a way to make a fast buck," says Michael F. Mangano, principal deputy inspector general of HHS.

While investigators used to focus on small operators, they're now looking for bigger players in all Medicare programs. In addition to the Columbia/HCA and SmithKline Beecham Clinical Laboratories Inc., accused of false billings for laboratory tests in a crackdown called "Labscam," reached a \$325 million settlement with Justice earlier this year. And last year, the University of Pennsylvania agreed to pay \$30 million after being accused of civil fraud by billing Medicare for services of teaching doctors when residents performed the work.

The hospital industry alone is under the separate HHS and Justice civil-fraud investigation. In the largest, enforcement actions are accusing 4,600 hospitals of violating a rule banning them from billing Medicare for outpatient services if the patient is admitted for the same condition within three days. So far, 2,000 hospitals, including Varnum's Mary Hitchcock, have paid \$47 million, and the government expects to collect \$200 million more.

Hospitals are irked by the probe. "Our folks are trying to take care of people, not trying to defraud the government," says Richard J. Davidson, president of the American Hospital Assn. But prosecutors counter that hospitals have long ignored warnings about the billing procedure. "They were put on notice, and they did not correct their systems," says Donald K. Stern, the U.S. Attorney in Massachusetts.

The feds' next target is managed care. I

spectors will look at whether managed care providers, which get a flat per-patient fee, are providing appropriate care. Their advice to health-care providers of all kinds: Take two aspirin, and expect a house call from federal agents in the morning.

By Susan B. Garland in Washington

By Catherine Yang

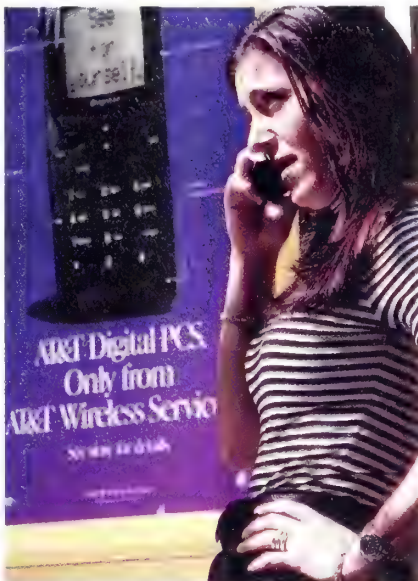
MEMO TO THE FCC: MAKE DEREGULATION WORK

This could be the defining moment for the Federal Communications Commission—and for the \$150 billion U.S. phone industry it oversees. The White House must name a chairman and, over the next few months, fill four vacancies on the agency's five-member board, just when the industry's painful lurch toward opening up competition appears to be stalling.

As things stand, the FCC is flirting with irrelevance. The agency was given broad powers to carry out the intent of the Telecommunications Act of 1996, a measure aimed at opening phone markets to greater competition. Long-distance carriers haven't opened into local-calling, and the Baby Bells haven't launched long-distance service. Instead, the two sides duke it out in public and battle it out in court. Giants such as Bell Atlantic Corp. and Nynex Corp. have decided to merge rather than compete with each other. And on July 18, a federal appeals court stripped the FCC of its important tool: its authority to regulate the prices charged by local phone companies for "interconnections" to their networks.

HOUSE RULES? That's why the next chairman, most likely William Kennard, now the FCC's general counsel, must move very quickly to prevent regulation from devolving into a hodgepodge of the U.S. telephone system. Under the appeals court ruling, each state can fashion its own rules to set the speed at which competition comes to local calling. That would create an inefficient patchwork of 50 different rules rather than one federal standard.

The FCC still has ways to pry open markets across the U.S., despite the July 18 ruling. Under the Telecommunications Act, it has the power to deny the



WIRELESS: Changing technology and new products challenge the FCC

Bells entry into the long-distance market until they open up their local monopolies to rivals.

Taking that kind of action is just what the FCC should now do. A useful precedent: holding the Bells to the same conditions imposed on July 19 in the FCC's approval of the Bell Atlantic-Nynex merger. There, the two companies agreed to refrain from some of the games monopolists play to block new entrants. They also agreed to help local-service rivals by granting access to phone-company computers so that the upstarts can easily switch service for new customers.

The FCC could codify these and other standards in across-the-board rules. It should set up federal standards and deadlines by which the Bells would have to provide new rivals with electronic ordering systems

that would make it as easy to change service providers as it is now in long distance. The FCC should also pass regulations to stop the Bells from imposing small inconveniences on customers who decide to switch service, such as not letting customers easily take their old phone numbers to a new carrier.

BULLY PULPIT. Meanwhile, the agency must exercise its prerogative under the new reform law to preempt anti-competitive rules at the state and local levels. The FCC should overrule a 1995 Texas law requiring the big three long-distance companies—AT&T, MCI Communications, and Sprint—to build their own local-calling facilities. The 1996 act says long-distance companies needn't lay their own fiber cable and copper wires—a costly proposition. They can choose to lease these components at a reasonable price from the Bells to get started in local business.

Kennard, if confirmed, should use his bully pulpit, too. Publicly naming companies that stymie competition or threaten to is an effective way of keeping telecom deregulation on the right track. Outgoing FCC Chairman Reed Hundt decried the very idea of AT&T's merging with SBC Communications Inc. instead of trying to compete with the Baby Bell in local service. AT&T and SBC scotched the plan.

While Kennard will stay busy tackling a large agenda—it will span wireless services, digital television, and cable TV—the first order of the day is the phone system. He will be judged on his ability to restore the promise of the Telecom Act. American consumers are counting on just that—and should expect nothing less.

Yang covers telecommunications policy from Washington.

THE FCC'S FULL PLATE

As chairman, Kennard would face a daunting must-do list.

DEREGULATION The FCC must find creative ways to open up competition in the local exchange market, or face criticism that the 1996 Telecommunications Act is failing.

WIRELESS The agency has yet to overhaul the botched results of last year's auction of

the wireless spectrum. Auction winners who are facing default are looking for debt forgiveness.

TELEVISION The FCC will have to deal with consumer complaints about high cable bills. And it will have to write rules governing the budding digital-TV industry.



KENNARD

COMPUTERS

BATTLE STATIONS!
BATTLE STATIONS!

PC makers gain ground in the \$15 billion workstation market

For years, personal-computer makers could only envy the lofty margins and deep loyalty that makers of engineering workstations earned from their corporate customers. Despite constantly improving technology, PC makers could never quite catch up to workstation companies, which kept introducing new generations of powerful RISC chips and improvements to Unix, the operating system for the most sophisticated programs—for designing cars, creating film animations, or drafting computer circuits.

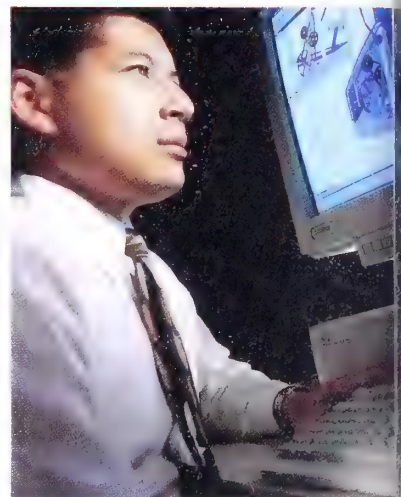
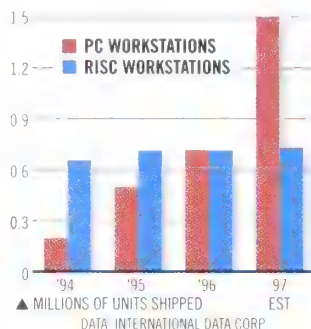
Now, PC makers are finally getting somewhere in the \$15 billion workstation market. The reason: Intel and Microsoft have made improvements in their chips and software that are specifically aimed at giving PCs the capabilities of workstations—but in machines costing 50% to 75% less than those made by Sun Microsystems or Silicon Graphics. “We have the

capability to change the market dynamic,” says Les Crudele, vice-president of the workstation division at Compaq Computer Corp.

Compaq, which aims to ship 100,000 workstations this year, is one of several PC makers that are chewing off a chunk of the low end of the market: Unit shipments of \$4,000-and-up PC workstations will be double those of traditional RISC/Unix machines this year, predicts International Data Corp. The latest entry is mail-order king Dell Computer Corp., which introduced

its first workstations on July 28. The machines, starting at \$3,700, are based on an Intel-supplied design and run Microsoft's Windows NT operating system. “We’ve worked hand-in-glove with Intel,” says Dell workstation marketing vice-president Linda Hargrove. “Our intent is to be one of the top two workstation vendors—if not the top.”

COMING ON STRONG



Workstations represent more than a fresh market opportunity for PC makers. Even while undercutting the workstation leaders on price, they hope to tighten their bottom lines. PC workstation margins are only about 30%—low by the standards of Sun or SGI but about a third higher than in conventional PCs. **KEY DEVELOPERS.** Two years ago, Intel and Microsoft began clearing the way into workstations for the PC makers. The chip and software giants began activating key software developers such as Parametric Technology Corp. and Solid Image Inc., encouraging them to rewrite workstation programs for the PC-based machines.

PC makers quickly jumped in. Intel and Compaq created workstation divisions. Compaq, Intel, and Microsoft teamed up to design multiprocessor

SILICON GRAPHICS: IS THE TURNAROUND HERE?

Silicon Graphics Inc. pulled off a bit of its old magic on July 24. The workstation maker—famous for machines that helped create films such as *Jurassic Park*, but stumbling recently (BW—Aug. 4)—posted June-quarter earnings that blew past analysts' expectations. The company reversed last year's loss with a profit of \$102 million on a 19% sales rise, to \$1.2 billion. The stock shot up 35% over two days, to 25% on July 25, and on July 30 closed at 24%.

Has SGI solved its problems and turned back the personal-computer upstarts? Not yet. But it has proved it has good running shoes. Chased by PC workstations at the low end, SGI is scurrying to sell bigger workstations and

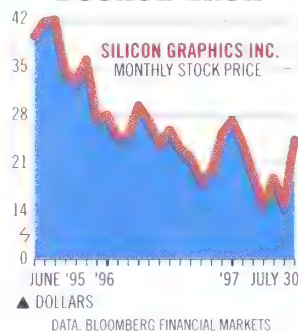
large-scale “servers” for corporate networks—the type of machines PC makers can't match. Server sales jumped 30% from the third fiscal quarter to the fourth, ended June 30. That and big shipments of \$20,000-and-up Octane workstations boosted gross margins six points, to 49%.

Even so, Windows NT workstations are giving the Mountain View (Calif.) company a run for its money. Sales of its low-end 02 model fell in the fourth quarter—even though

SGI had solved earlier shipment

Whether SGI can sustain the momentum is unclear. While sales of some \$150 million in backlog fell by \$20 million—indicating that sales boost came from shipping products customers ordered earlier this year. And William Kelly, senior vice president for corporate relations, says the third quarter could show “much larger” sales than the usual 10% per dip, thanks to a strong fourth quarter.

BOUNCE-BACK



SOLIDWORKS: Dassault bought the startup for \$320 million

workstations. PC makers Hewlett Packard, IBM, and Digital Equipment—all of which also make Unix workstations—have added PC workstations. Microsoft even makes sales calls with HP to promote PC workstations.

Traditional workstations won't fade away, though. Hundreds of customers rely heavily on RISC/Unix machines and the software that runs on them. Ed Mehalick, director of engineering systems at Lockheed Martin Corp., which has 30,000 Unix workstations, says the cost of retraining engineers on PCs would overshadow any savings. "We've standardized mechanical CAD, electronic design, software engineering on Unix," says Mehalick. "We're not moving off that me soon."

Still, the low prices of PC workstations mean that companies such as Lockheed Martin will have to consider them. And, the defense giant is evaluating a PC workstation for future buys. One of how hot PC workstations are being: On July 29, French mainframe supplier Dassault Systèmes raised SolidWorks for \$320 million—whopping 44 times last year's revenue for the PC workstation company. With momentum like it's the PC workstation crew that's the envy of the industry.

By Gary McWilliams in Houston

plans to keep its comeback. "We are very optimistic about this year and beyond," Executive Vice-President Gary L. Lauer declares in a letter to shareholders (page 10). Sources at 200 SGI engineers are designating the new workstation using Intel's Pentium and Windows NT to counter the competition. The new machines will appear for six months, but customers are eager for them. Says Michael J. Berman, a technology manager at Texaco, "We need to spend a lot more attention on the low end."

SGI has to fend off rivals like Sun Microsystems Inc. Sun has four times SGI's revenue and regularly posts strong growth. Such consistency is key for capital-commercial buyers SGI craves, says analyst Martin Pyykkö. "It takes more than one good quarter to prove itself."

Robert D. Hof in San Francisco

'TWO FOR ME, NONE FOR YOU'

An edgy crop of Gen X ads rudely pushes the envelope

What ever happened to those smiling young folks who wanted to teach the world to sing in perfect harmony and buy everybody a Coke?

They're history. In Coca-Cola's latest campaign, Gen Xers are battling one another in a race to the top of a muddy hill. The prize: a single bottle of Coke's latest carbonated beverage, Surge.

Advertisers are trying to push a new button—and not just for Coca-Cola Co. Instead of creating ads around situations most people want to identify with, some of the more successful new ads stress the world's limited resources and the need to move quickly and aggressively if you want to get yours.

Kids and young adults, who absorb an average of 20,000 TV commercials a year, are all but immune to softer appeals, advertisers say. To reach this much sought-after demographic group, pitchmen are willing to get a little rude and risk making other consumers squirm.

"If you go out with the idea that you're not going to offend anybody, you probably won't make an impression," says Jamie Barrett, a creative director at Wieden & Kennedy Inc. in Portland, Ore., which recently did a campaign aimed at Gen Xers for Miller Genuine Draft beer. The tag line on the ad: "It's time to shut up and drink some beer."

GOODBYE CIVILITY. Consider the new campaign for M&M/Mars's Twix snack foods by D'Arcy Masius Benton & Bowles Inc. Mom may have taught you to share, but Twix's new slogan—"Two for me, none for you"—advises consumers to wolf down both chocolate wafers themselves. An M&M/Mars spokesperson describes the campaign as a "fun, tongue-in-cheek thing."

But beneath the humor is a somewhat hostile message, says Robert Goldman, a sociology professor at Portland's Lewis & Clark College and co-author of

Sign Wars, a book about the cluttered landscape of advertising. Goldman worries about what the new ads say about society. "The big issue is that they seem to reflect a loss of civility," he says. "In this kind of world, jokes about personalism and materialism are funny."

Not even references to death are off limits. A new commercial launched in June for Nabisco Inc.'s Air Crisps crackers shows a young man ostensibly comforting a grieving widow. His real goal, though, is to get his hands on a nearby bowl of Air Crisps. The punch line: "[The deceased] would have wanted me to have these."

HELLO SALES. Similarly, in Infiniti commercials that began airing in May, one setting is a burial service where a man's corpse is being lowered into the grave—inside his luxury sedan. His wife sobs as one mourner leans over to another and delivers the kicker: "She really loved that car."

Tasteless? Sure. But the ads seem to



SURGE TV SPOT: Nowadays, the winner takes all

be working. Infiniti sales for June were up 56% from a year ago, and a spokeswoman for Infiniti says the ads were a factor. Surge has grabbed a 1% share of the soft-drink markets where it was launched in January. That puts it on a par with caffeine-free Diet Pepsi, the No. 10 soft drink, according to *Beverage Digest*. And June sales of Air Crisps were twice the May levels.

That's why, despite the negative message in many of the new spots, ad execs are proud of the campaigns. "If you have to scream louder or whatever, then so what?" says William Oberlander, executive creative director at Kirshenbaum Bond & Partners in New York. "No one's really worrying about what it's teaching impressionable youth. Hey, I'm in the business of convincing people to buy things they don't need." By any possible means.

By Thomas Bartlett in New York

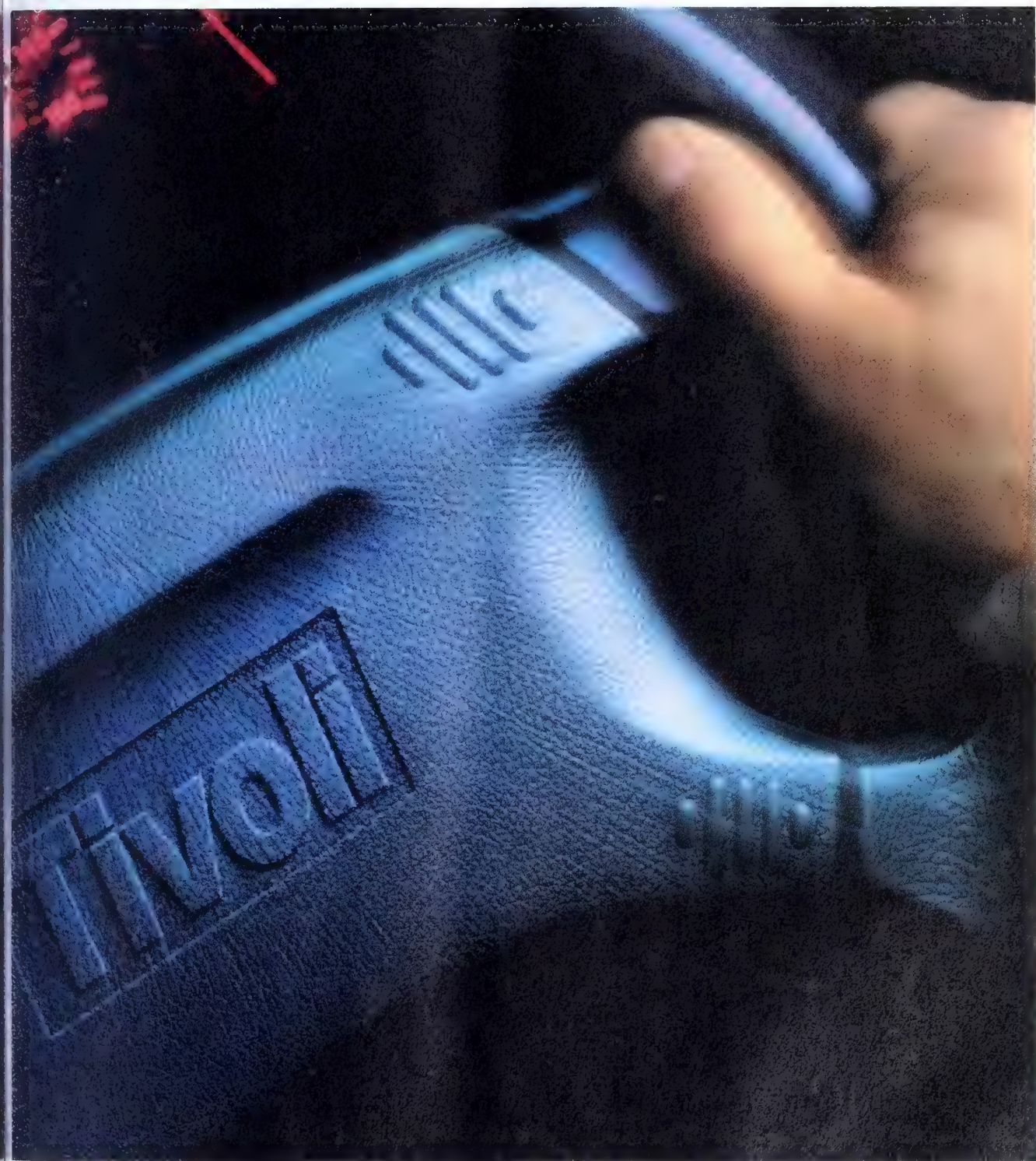
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SPORTS BUSINESS

IS GREG MURPHY HEADED FOR THE SHOWERS?

Support for Major League Baseball's marketing czar is slipping

Major League Baseball's embattled marketing chief, Gregory B. Murphy, is getting kicked out of his office—literally. Now the only question is whether he will be kicked out of the organization, too.

The former Kraft Foods Bakery Cos. CEO will soon vacate the corner office at baseball's Park Ave. headquarters—once reserved for the commissioner. There's still no full-time commissioner, but on July 22, the organization named former Toronto Blue Jays chief executive Paul Beeston chief operating officer, its first in five years. He'll be the top exec in New York, while Acting Commissioner Allan H. (Bud) Selig will keep running the game from Milwaukee.

The naming of Beeston, a friend of Selig's who is respected by both owners and players, increases the likelihood that Selig will one day become commissioner, observers say. And it has reignited long-simmering rumors that Murphy is on his way out. "The sun will come up tomorrow. You will pay taxes this year. And Greg Murphy is history," says an associate of Selig. "I absolutely flat guarantee it—because Bud told me so."

LOST GROUND. Of course, that's what unnamed baseball executives have been saying for months. Murphy remains unmoved. And, he asserts, his prospects have improved with the arrival of Beeston, who he predicts will end the sniping. "That will stop all the sideshows and get everyone focused on what's important," Murphy says.

But if Murphy is ousted, it would signal the owners' retreat from the marketing initiative they hired Murphy to launch after Major League Baseball's disastrous 1994 strike—and to take back ground lost to basketball and football over the course of decades. The plan was to lift a page from pro basketball's book and convince owners to band together to market the game, not just their teams.

From the outset, Murphy clashed



SQUEEZE PLAY: Former Kraft CEO Murphy is an outsider. Beeston, a former Blue Jay chief, is a friend of Acting Commissioner Selig

with owners. In November, they rejected a proposed pact with Nike Inc. and Reebok International Inc., furious that Murphy hadn't consulted with them on its terms and unhappy with what their take would have been. Then, on the same day in March that Murphy unveiled his marketing plan, New York Yankees owner George Steinbrenner upstaged him with a renegade Adidas-Yankees deal.

If nothing else, Murphy clearly underestimated what it would take to get Major League Baseball—a collection of 30 clubs—to agree on a single marketing effort. Now, he concedes, meeting his goals "will take longer than I naively expected when I first start-

ed." Indeed, he didn't come close to target of snagging \$100 million in annual sponsorships by the end of last year. But deals are now pending with Anheuser-Busch, Visa, and Quaker Oats. Gatorade that would bring Murphy close to that figure.

Murphy has had some success. All his hawking has increased other marketers' interest in the game and boosted the fees that local clubs have been able to get for their own deals. "There's a newfound spirit of cooperation and level of importance put on marketing of the industry versus individual teams," says Florida Marlins President Don Sr. Ley, a director of Major League Baseball Enterprises, of which Murphy is CEO.

None of that has stopped the bad biting, though. And Selig's public support for Murphy couldn't be more tepid. Asked about Murphy during a conference call with Beeston and reporters on July 24, Selig noted that creating a separate division for baseball marketing arm was the correct move, adding, "Greg has been its first president, and other than that, there is no appropriate comment."

Meanwhile, baseball's comeback from the nadir of '94 seems well in hand. Attendance is nearing the record levels reached before the strike, and stars such as Seattle's Ken Griffey Jr. and Toronto's Roger Clemens are electrifying crowds around the country. At the same time, an owners' committee, led by Jerry McMorris of the Colorado Rockies, has hired headhunters Heidrick & Struggles Inc. to cobble together a list of roughly 25 candidates for commissioner, according to one

owner. Depending on whom they pick, Beeston's tenure in that Park Ave. corner office could turn out to be short-lived, too.

By David Leonard in New York, with Gail DeGeorge in Miami and Mark Hyman in Baltimore



SAVIN JUST WON OVER SOME OF THE TOUGHEST JUDGES AROUND.



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*Turn your knuckles
white*

with tension

Or simply refuse to go

where you point them, taking you

off course and into danger. ↗ That's why

*Cadillac has developed StabiliTrak, the most advanced
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credibly sophisticated sensors, StabiliTrak constantly compares where you want the new Seville STS to go with where it's actually going. ➤ If StabiliTrak determines the STS isn't following your intended steering path, it sends signals to the

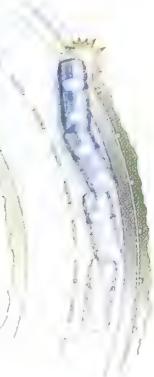


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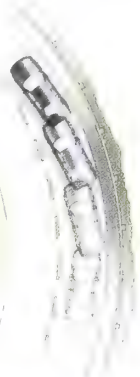
Without StabiliTrak

In this situation, the driver is going too fast on a wet, icy road. The driver tries to bring the car back into control, but the vehicle spins out and strikes a guardrail.



Seville STS with StabiliTrak

In the same situation, the driver of an STS with StabiliTrak experiences the vehicle beginning to fishtail. StabiliTrak senses the discrepancy between the steering angle and the actual direction of the car and precisely applies the front brakes to help guide the vehicle back onto its intended path.



SEVILLE STS

THE POWER IS YOURS

EDITED BY KELLEY HOLLAND

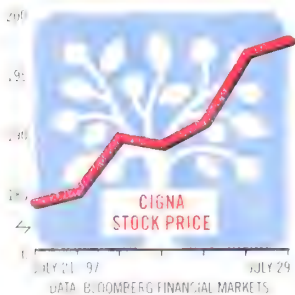
IMPASSE OVER THE AMERICAN-BA DEAL

FRESH FROM JOUSTING WITH Boeing and McDonnell Douglas, the European Union may take on the deal between American Airlines and British Airways. EU regulators have drafted a tough list of conditions, including demands that the airlines give up 353 Heathrow slots—more than double what British regulators had recommended—before it will approve the alliance. The slots would be given away free to rivals. The EU also may insist that AA and BA halve the number of flights on many routes between Britain and the U.S. Worse, the EU says it won't rule on the deal until September at

CLOSING BELL

A SLIMMER CIGNA

CIGNA shareholders cheered on July 28 when the Philadelphia insurer said it would sell its life-insurance business for \$1.4 billion to New York Life. The news sent CIGNA stock up by 5½%, to 196½¢. The sale is part of a move by CIGNA to cut its consumer business while expanding corporate health-care and property insurance operations. In June, it bought Healthsource, a managed-care insurer, for \$1.7 billion. Analysts figure cash from the life-insurance sale could fund more buys or a share buyback.



the earliest. BA CEO Robert Ayling has threatened to pull out of the deal if it's not approved by November.

MORGAN DISCOVERS MUTUAL FUNDS

FOLLOW THE MONEY: J.P. Morgan is expanding beyond its longtime focus on institutions and the wealthy, announcing on July 30 that it would be taking a 45% stake in no-load fund manager American Century for \$900 million. "Demographics is destiny," says Ned Kelly, a managing director of Morgan. "As the population ages, asset management will continue to grow." American Century's focus on growth stocks contrasts with Morgan's more conservative investing style. But Morgan won't change its stripes, says Kelly. "It's structured so each of us preserves autonomy. We'll work to build value together."

YAHOO! AND VISA, TOGETHER AGAIN

IT'S AS IF THEY GOT REMARRIED before the ink on the divorce decree dried. Yahoo! and Visa International on July 29 ended a 16-month-old joint venture to create an electronic-commerce Web site. So Yahoo! will hand over \$21 million in stock to Visa in exchange for its 45% share of the joint venture and take a \$21.2 million pretax charge against second-quarter earnings. But the romance continues. The companies simultaneously announced a raft of new projects, including a co-branded Yahoo! Visa card.

ALCOA'S SPANISH BRIDE

ALCOA CHAIRMAN PAUL O'Neill is making good on his promise to create the world's largest aluminum company

HEADLINER: BRIAN HALLA

POISED TO PUMP OUT INFO APPLIANCES

Brian Halla has been a whirlwind at National Semiconductor. Since becoming CEO in May, 1996, he has repositioned the \$2.5 billion chipmaker to become a key supplier of chips for "information appliances" such as handheld PCs.

On July 25, Halla worked through his 51st birthday to put the finishing touches on the one missing element in his plan: an Intel-compatible microprocessor. Three days later, he sewed up a \$550 million deal to buy Intel cloner Cyrix of Richardson, Tex. "I couldn't think of a better

present," says Halla.

The Cyrix buy puts National in pole position the race against Intel, SGS-Thomson, and others to shrink the parts of a PC onto a single chip. Cyrix already supplies Compaq Computer with the chip for a \$79 PC. Now, Halla must meld Cyrix' processors with National's low-power circuits and video chips to make the plan work. "We have all the pieces to put together a complete PC system on a chip," boasts Halla. He promises that the first products will be available by next May.

By Gary McWilliam



from \$13 billion to \$20 billion by the end of the decade. On July 29, Alcoa shelled out \$410 million for Spain's state-run Inespal. The deal should add \$1.1 billion in revenue, but wringing profits from Inespal will be a challenge: It has lost money for years. Still, with the price of aluminum near a five-month high, making money should get easier. Alcoa stock rose on the news to a new one-year high of \$88.50 a share.

BT-MCI CLEARS AN FCC HURDLE

BRITISH TELECOMMUNICATIONS and MCI Communications may soon get a blessing for their impending union from the Federal Communications Commission. Now that FCC Chairman Reed Hundt gave his personal O.K. to the deal on July 28, the FCC could approve the \$20 billion merg-

er in late August. The two companies had agreed to several conditions to satisfy Hundt, including a promise that the FCC can stop MCI from accepting BT long-distance traffic if BT fails to comply with expected rules to open long-distance markets. MCI could use some good news: On July 30, it reported \$280 million in second-quarter earnings, a 6.7% drop because of slower long-distance growth and losses in its local business.

ET CETERA...

- Fujitsu announced a tender offer to buy the 58% of Amdahl it does not yet own.
- Donna Karan named Joelle Idol to succeed her as CEO of her clothing company.
- Modem maker Hayes Microcomputer will merge with Access Beyond.
- Western Resources and Protection One will combine their security businesses.

EDITED BY OWEN ULLMANN

HOW THE GOP COULD BRAWL 'SELF OUT OF POWER

These should be glorious days for Capitol Hill Republicans. They just engineered a balanced-budget pact with a family tax credit and lower capital-gains rates. They've led President Clinton to reform the welfare system. And the public buys their less-government mantra. But victory has a cost: bloody infighting between center-right pragmatists willing to cut deals with Clinton and conservativeists bent on radical change. The warfare raises fresh doubts about the GOP's ability to keep its coalition intact.

Emboldened by the failed right-wing assault against an increasingly flexible House Speaker Newt Gingrich (R-Ga.), compromisers are on the offensive. Moderate William F. Weld quit as Massachusetts governor on July 29 to wage war with conservative icon Jesse A. Helms (R-N.C.), the Senate Foreign Relations Committee chairman who is blocking Weld from becoming Ambassador to Mexico. At stake is not just a diplomatic victory, but the GOP's long-term appeal to the swing voters turned off by the party's ideological zeal.

ING IN? To his backers, Weld is standing up to Helms and other extremists to save the party from shoving moderates out of the GOP tent. To the right activists, Helms is a hero and Weld is emblematic of the "collaborators" who sell out to Clinton. Even Senate Majority Leader Trent Lott (R-Miss.), a staunch conservative, has come under fire for questioning sexism in the military and opposing a chemical-weapons ban. "We should change our tune to the Cave-In Party," huffs a House right-winger. That view is shared by a powerful bloc of activists—ranging from religious conservatives to supply-side purists. Such ideological fervor—combined with widespread voter discontent over the economy—helped the GOP capture Congress in 1994. Now, with the good times rolling, complacent voters see

little need for revolutionaries. "We're getting things done because we're making accommodations," says Representative Sherwood L. Boehlert (R-N.Y.), a leading House moderate. "The problem with the [hard-liners] is that they think it's a cardinal sin to make any accommodation."

The intensifying discord could imperil the GOP's 11-seat House majority in 1998. Faced with a tough campaign, Republicans can't afford to look as though they're hostage to the Far Right. But neither can they snub the religious conservatives who've helped them capture former Democratic seats in the South and Midwest.

"None of this is good for Republicans in '98," concedes conservative activist Karen Kerrigan, president of the Small Business Survival Committee.

NICE TILT. For now, the balanced-budget deal is a rallying point for all GOP factions. Budget hawks are pleased that it will erase decades of red ink. Supply siders extol its capital-gains tax cut. Social conservatives like the "pro-family" tilt. And moderates hail new spending on education, health care, and the environment.

But the unity will dissolve in the scramble for the 2000 Presidential nomination.

Weld—or another moderate, such as New Jersey Governor Christine Whitman—may battle a Religious Right favorite, such as former Vice-President Dan Quayle. And the champion of another faction, supply sider Steve Forbes, looks like he's going to throw his checkbook into the ring again.

Democrats may face splits within their own party, too, as New Democrats vie against traditional liberals. But for now, Dems are managing to keep their differences under control. If the Republican purists don't listen to the voters and make peace with the pragmatists, they may find themselves waging their revolution again—as the minority party.

By Richard S. Dunham



WELD dives into the Charles last year. This summer, it's the Potomac

CAPITAL WRAPUP

FINDING A CODE FOR COMPROMISE

A long-running battle between Washington and Silicon Valley over a vital high-tech issue—how to keep online information secure—may finally come to a peaceful resolution this fall. The dispute is over encryption software that scrambles electronic data to protect it from prying eyes. Business needs it to conduct confidential transactions on the Internet. But the FBI and the CIA fear they will be hampered by use of secret codes. So the feds are restricting exports of encryption software

and want makers to create codes that law enforcement will be able to break.

In September, the House will vote on an industry-backed bill that would remove most export limits, a move that could mean up to \$9 billion a year in overseas sales. The Senate is moving in the opposite direction: It's considering an Administration-backed measure that ensures government access to the codes. But Senator John McCain (R-Ariz.), a chief sponsor, says he'll explore a middle ground with industry reps. Senate Judiciary Committee Chairman Orrin G. Hatch (R-Utah) and ranking

Democrat Patrick J. Leahy (Vt.) may write a more pro-industry bill.

If business is willing to deal, a compromise could be forged around the idea of giving the feds limited control over decoders. A big impetus for a settlement: Both House Speaker Newt Gingrich (R-Ga.) and Senate Majority Leader Trent Lott (R-Miss.) have Silicon Valley connections that make them sympathetic to the industry. "The score is tied now," says Commerce Under Secretary William A. Reinsch. "But we're going to get it done."

By Catherine Yang

Borne till the 4th of Jul
product began its life o



When a down-to-earth lars.



This Independence Day, we were pleased to be part of a safer, gentler Martian landing.

*Pathfinder has landed –
on airbags with fibers
made by Celanese.*

Seconds before touchdown, the airbags were inflated in order to cushion Pathfinder's landing on the surface of Mars. Thanks to Vectran®, a stellar-strength fiber from Celanese, a member of the Hoechst Group, the airbags didn't burst under the spacecraft's impact.

Of course, you can experience the advantages of Vectran right here on planet Earth.

In high-performance yacht sails and seismic arrays on ships that map the ocean floor. Or in tennis rackets and golf clubs to help you make your best shots. It's even found in identified flying objects – like airships.

We keep on finding new ways to make life better.

Here, there and everywhere.

Hoechst is an international group of companies spearheading innovation in Life Sciences and Industry. With more than 140,000 people worldwide, last year's sales totalled \$ 34 billion.

Finding new ways.

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INDIA

INVESTING IN INDIA: NOT FOR THE FAINTHEARTED

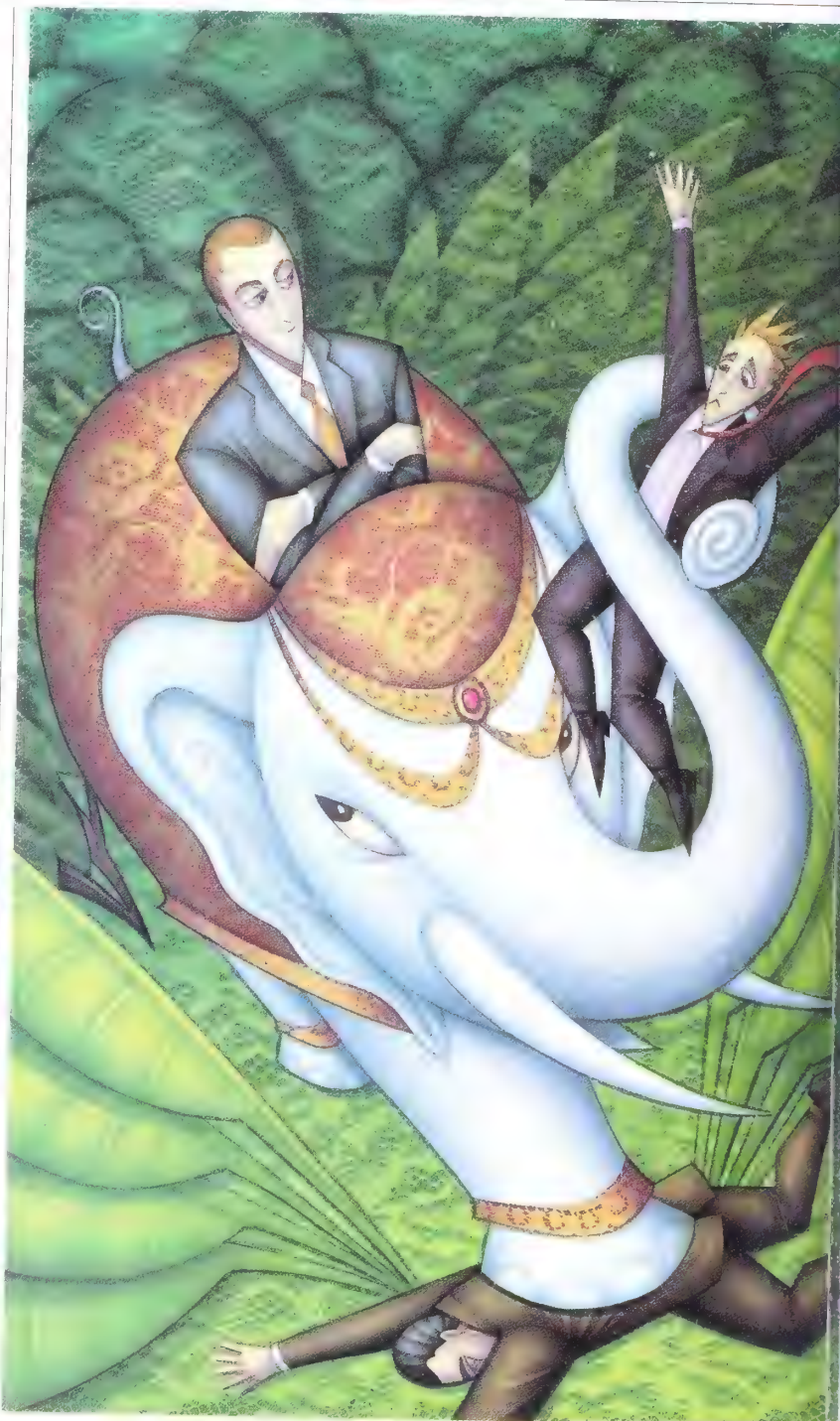
Foreign companies see vast potential. But pitfalls, like finicky consumers, abound. Here are some lessons

It looked like a can't-lose proposition. In 1995, Mercedes-Benz opened a plant in India to manufacture its E-class sedan and win over India's new rich business class. Two years later, the plant is using only 10% of its 20,000-car capacity. Indians turned up their noses at the car—a model older than those sold in Europe. Now, Mercedes has to reassess its mistakes and start exporting extra cars to Africa.

As Mercedes found, doing business in India can be gut-wrenching. India's demanding consumers can be difficult to read. Political squabbles, bureaucratic delays, infrastructure headaches, and unprofessional business practices create one obstacle after another. Foreign companies are often viewed with suspicion. For most of its postcolonial life, India has shut out the world, adhering to a socialist ideal of self-reliance. The nation's fragile unity came with the departure of Britain in 1947 and at the expense of partition with Pakistan. As India celebrates its 50th anniversary of independence on Aug. 15, many remain wary of anything that might pull the nation apart—even foreign funds.

WIDE DIVERSITY. Yet policymakers have been struggling for the past six years to lure capital and ignite growth. In 1991, New Delhi dramatically rejected socialism and admitted foreign investors. Now, the companies that ventured in are tallying their profits and losses and wondering what the future holds for this market of 950 million people.

What they have learned is that India, so far, has fallen short of its promise and that the task of reforming the economy is half-finished. Companies have been burned by their own optimistic assumptions. Others, after researching the Indian market, have decided not to invest at all—at least for now. Only \$2.6 billion was directly invested in India last



a figure dwarfed by investment in India, which attracted \$42 billion. But there is a positive story to tell. Investors can make money if they're careful and choose local partners carefully. The government, despite its political turmoil, presses on with reform. Foreign investment is rising by double digits. And the Indian stock market has gained 35% on hopes that New Delhi will keep its pledge to

open India more attractively to business. Foreign companies can learn from the first wave of investors and find keys to how this tricky market really works.

The primary lesson is not to be dazzled by India's size. The Indian government used to boast of 250 million middle-class consumers. But

the latest survey says they number 100 million at best—and there's much stratification among them. India has 17 official languages and an ethnic diversity as vast as all of Europe. People in Madras taste vastly different from people in Punjab.

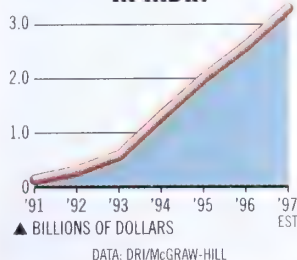
IS BLAZING. Entrenched players have a big advantage. Anglo-Dutch conglomerate Unilever, for example, began selling soap and toothpaste in India in the heyday of the British Raj. It has the distribution muscle of 3,500 salesmen selling to 10 million small shops in rural India—figures to give competitors pause. "Multinational corporations must not start with the assumption that this is a barren field," says C. K. Prahalad, business professor at the University of Michigan. "The market is not too big."

Consumer-products giants such as Kellogg Co., based in Battle Creek, Mich., have seen their brand power severely tested in India. Kellogg dreamed of 50 million cereal-eating Indians. So in 1994, with a \$65 million investment, it launched Corn Flakes in India. The product did well initially, helping to double the market for breakfast cereals. But it soon plummeted because a 500-gram box of Kellogg's product costs 33% more than its nearest competitor. And in a country where breakfast is usually a bowl of hot vegetables, cold cereal is a novelty—a one-time purchase. "It was easy cultural homework," says Titoo Iyengar, head of market researcher MARG in Bombay. A Kellogg spokesman says the company still has a foothold in the cereal market and remains committed to India.

The same elusive dream of tapping millions of consumers also lured auto makers. After 1991, Ford, Gen-

eral Motors, Daewoo, Mercedes and Peugeot all teamed with domestic carmakers but were blocked out of the low-cost segment by Japan's Suzuki Motor, which, in collaboration with the government, has 80% of the passenger-car market. So the new entrants all launched midsize cars priced too high for India—around \$22,000. So many plants have been built that capacity will be 1 million vehicles,

FOREIGN INVESTMENT IN INDIA



way over the 600,000 estimated buyers, by 2000. Auto makers are now making fewer cars than planned and exporting the extras.

In other cases, a local partner turns out to be a liability. Germany's Lufthansa learned the hard way with the \$2 billion Modi Group, which has joint ventures with such blue chips as Walt Disney, Rank Xerox, and Revlon. Lufthansa signed an agreement in 1993 with Modi brother S. K. Modi to launch domestic private airline ModiLuft. But execs soon realized the group was not a smoothly functioning entity: The five brothers were feuding bitterly. The airline went bust in 1996. And Lufthansa claims—in a lawsuit filed in Bombay last year—that S. K. Modi reneged on pay-

court cases. "We've learned a lot of patience," says Sanjay Bhatnagar, Enron's country manager. And now the Indian government cites Enron's victory in all of its 24 lawsuits as proof that foreign investment is backed by the rule of law.

Other power companies have learned from Enron and staged lower-profile entries into India. Oil-and-gas giants such as Royal Dutch/Shell Group, have been painstakingly building alliances with India's public-sector oil-and-gas companies. Says Shell's chairman in India, Vikram Singh Mehta, who has a joint venture with government-owned Bharat Petroleum Co.: "Only mutual interest will survive the long run."

SURPRISES. General Electric Co., has shared this cautious approach, with positive results. The U.S. giant arrived in '91, when Indian law started letting foreigners set up wholly owned subsidiaries rather than have to find local joint-venture partners. Still, GE chose Indian appliance maker Godrej and sent over a crack team to make sure it could deliver. Then, GE hired local managers and made them meet U.S. standards. The tie-up aided both companies: Godrej got GE technology to upgrade its appliances; GE got Godrej's good reputation and distribution system. Godrej-GE now has a 40% market share, and GE uses India as a low-cost manufacturing base for light-

SIZING UP THE SUBCONTINENT

The Good...

GROWING MARKET Middle-class consumers number 100 million, and the group is growing

PROMISING LABOR FORCE Wages are low, and many workers and midlevel managers are well educated and speak English

SURGING STOCKS Investors are showing their optimism by bidding up local stocks 35% this year

DATA: BUSINESS WEEK

ments and used the German company's funds in other new ventures. Lufthansa is seeking \$18.6 million plus the return of three planes it says Modi kept. S. K. Modi, despite repeated attempts by BUSINESS WEEK, could not be reached.

The mother of all investment lessons comes from Houston's Enron Corp. Before it finally prevailed in plowing India's first private power project through a shifting political climate, Enron probably made things worse for itself. It came in with "both guns blazing," says one foreign exec—and alienated many. The project was dogged by controversy and got bogged down in two years' worth of

...And the Bad

INEFFICIENT BUREAUCRACY Corruption, red tape, and special interests keep a lid on growth.

INFRASTRUCTURE Inadequate roads, harbors, and airports, as well as poor telecommunications, limit export potential

POLITICS Constant changes in government, and party strife, hold back further economic reform

bulbs and X-ray equipment. "We're here for the long term," says Scott Bayman, head of GE-India. "There'll be bumps along the way, but these markets are not for the faint of heart."

Above all, companies must be prepared for surprises. Coca-Cola Co., for example, bought the local maker of a popular soda, Thums Up, and wanted to use its distribution system to build Coke's dominance. But Thums Up holds the No. 1 spot: Indians think Coke doesn't have enough fizz. That's how it can be in India—a surprise, but also an unexpected reward.

By Manjeet Kripalani in Bombay

COMMENTARY

By Pete Engardio

WESTERN DEVILS AREN'T THE PROBLEM IN EAST ASIA

East Asia's leaders hardly knew what hit them. Early last year, the region's Tiger economies were cruising along as they had for a decade, the envy of the world. The end of the party was shockingly swift. In the past two months, currencies from the Malaysian ringgit to the Indonesian rupiah have been pummeled. Thailand, a World Bank darling just four years ago, is now at the mercy of the International Monetary Fund. In South Korea, the huge Kia Group and four other *chaebol* have collapsed under mountains of bad debt.

But even as the economic damage spreads across the region, Asian leaders still seem to be in denial, unable to admit that anything is fundamentally flawed in the old strategies that brought go-go growth. When Asian economies started sputtering last year, the slowdown was first blamed on cyclical blips in overseas export markets. When currencies came under attack, Asian central bankers pointed to speculators. Even today, Malaysian Prime Minister Mahathir Mohamad claims, absurdly, that Southeast Asia would be humming along fine were it not for a politically motivated Western "conspiracy."

ASLEEP AT THE SWITCH. Currency traders may be greedy and insensitive to the plight of a developing nation. But pinning the blame for East Asia's financial mess on George Soros is cheap political cover for the mistakes of its leaders. The hard truth is that speculators recognized that many East Asian economies were locked on a course that was unsustainable. Asian policymakers should have awakened to the danger signals long ago. Despite their nations' yawning current account deficits and heavy dependence on exports, many Asian countries refused to let their currencies

adjust to the yen's 40% decline against the dollar since 1995. And despite persistently poor corporate earnings and an alarming rise in bad debts, leaders continued to let their banks subsidize ill-conceived, reckless investments in property developments and industrial complexes of powerful business interests and corrupt cronies.

Now, policymakers are in a serious

capacity utilization averaging just 60%.

How can Asia's Tigers get out of this jam? Bailouts won't be a cure unless accompanied by a restructuring of the region's industrial and financial landscape, however painful. Thanks to the currency meltdown, the first stage of a shakeout is under way. Thailand has begun shelving plans for new chemical plants. In Malaysia and In-

donesia, investors are halting steel and paper mills.

THINK BIG. A real cleanup will require mergers in everything from cars and telecoms to banks. And longer term, nationwide consolidation is needed. In Southeast Asia, few producers of chemicals, electronics, and aircraft, to name a few sectors can compete outside their own protected markets.

However, if they

had access to all of Southeast Asia's 500 million consumers, companies efficient enough to compete globally should emerge. That's one concept behind the ASEAN Free Trade Area pact to cut tariffs on most goods traded within the region to near zero by 2000. Several countries are backsliding to shelter their steel, chemical, and telecom industries. This free-trade agenda needs to stay on track.

But revamping industry will be wrenchingly difficult for East Asia's politicians. In the fledgling democracies of South Korea and Thailand, they must somehow face down powerful tycoons who fund their political empires. Elsewhere, autocrats who have based their legitimacy on perpetually high growth have to let go of white-elephant projects. For public consumption, leaders still will try to blame foreigners. But as they do, they also should start preparing their citizens for tougher times.

Senior News Editor Engardio tracks Asian economic trends.



IN DENIAL The Tigers must face the fact that their woes stem from mistakes made right at home

bind. Banking systems, especially in Thailand and South Korea, don't have the funds to bail everyone out. And throughout the region, there is a glut of capacity in everything from automobiles to chemicals. The heat is only getting more intense as China continues to come on strong. Having already displaced many of its neighbors in garments, toys, and watches, China is a rising power in such sectors as consumer appliances, auto parts, and telecommunications equipment. While its neighbors' exports were flat, China's soared by 26% in the first half of 1996. And that happened despite ca-



**Your business
isn't something
you should
entrust
to people who
think small.**

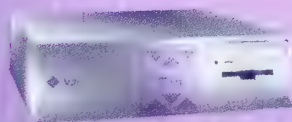
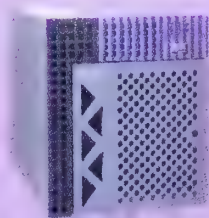
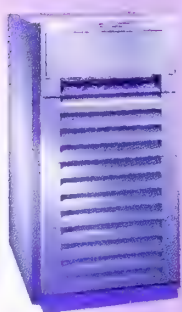
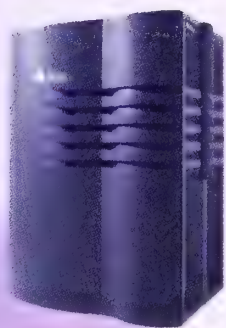
To build,
you need a
grand plan.

It's the grand plan that makes the difference between a building that stands and a building that falls. It's the grand plan that makes the difference between a building that is built to last and a building that is built to fail. It's the grand plan that makes the difference between a building that is built to serve and a building that is built to be served. It's the grand plan that makes the difference between a building that is built to be a part of the community and a building that is built to be an island. It's the grand plan that makes the difference between a building that is built to be a part of the future and a building that is built to be a part of the past.

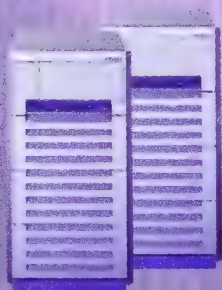


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TAIN

NEW BROOM FOR THE CITY

financial services will come under the eye of one supercop

It is a hot summer afternoon in London, and the spacious office in the Bank of England is sweltering. But heat doesn't seem to bother Deputy Governor Howard Davies. While waiting to be summoned to a meeting with bank governor Eddie George, he thinks over his weekly soccer match from which he just returned. "This is hard, competitive stuff," he says of the game. He might as well be talking about his next job. Tony Blair's Labour government has tapped the 46-year-old Davies to help keep its promise to clean up Britain's scandal-plagued financial industry and beef up protection of investors. Beginning on Aug. 1, Davies will head the Securities & Investments Board, Britain's top securities regulator.

Davies will oversee a reworking of the way Britain's financial industry, which contributes an estimated \$250 billion a year to the economy, is policed. His four wants to expand the SIB to monitor virtually the entire sector. The so-called self-regulatory organizations (SROs), which are industry-funded and oversee discrete activities, will be dissolved, and the Bank of England will lose its key role in bank supervision. Davies will monitor everything from mutual funds to commodities trading to insurance.

His redesign of Britain's regulatory system has big opportunities and big risks. If Davies manages the task successfully, London could set a paradigm for central regulation in a world where financial disciplines are increasingly integrated. And one-stop regulation could make it easier to coordinate capital to coordinate with their counterparts in another.

For example, in the events leading to the 1995 collapse of Barings PLC, Bank of England supervisors were unaware of the wild futures trading occurring at the Singapore branch of the bank's securities arm, which fell more under the jurisdiction of an SRO. Although lax management was the primary cause of the crisis, a more centralized regulator might have spotted the improprieties.

BIG BASKET. But some experts ask whether it makes sense to consolidate supervision of such different industries as insurance, commodities trading, and investment banking. "Fitting all that under one roof is going to be a challenge," says U.S. Federal Reserve

Board Governor Susan Phillips. "I'm not sure all of the ramifications have been thought out."

There also is controversy over what the governing philosophy should be in the new system. British prosecutors want it to resemble the U.S. Securities & Exchange Commission, where investigators actively track down fraudsters. But the attitude toward financial crime has traditionally been softer in London, where banks fear losing clients to offshore rivals. Warns one senior banker: "If you impose a strict regime in a free market, other centers that aren't so inhibited will draw away business." So Davies must walk a fine line between reassuring industry players and delivering the clean markets his Labour bosses demand.

Davies believes that speaking with one regulatory voice will help Britain advance its interests in Brussels and in international financial circles. He has already gone on the road to explain the new system to the U.S. Federal Reserve, the Bundesbank, and the Hong Kong Monetary Authority, to make sure

that lines of communication stay open during the transition. And he says he finds "a huge amount of interest" in the experiment.

QUICK STUDY. The choice of Davies to carry it out could make Blair and Chancellor of the Exchequer Gordon Brown look smart. Well-connected politically, Davies is considered one of Britain's most flexible managers. "He is extremely quick at picking up a new situation," says Sir David Lees, chairman of GKN PLC, a big industrial company on whose board Davies served.

Davies intends to have most of the new organization in place by next spring even though the enabling legislation won't come until 1999. But all the planning in the world won't shield Davies if another Barings materializes in the razzle-dazzle City. He has led a charmed life so far. But he will need all his skill and not a little luck to keep it going.

By Stanley Reed in London, with Dean Foust in Washington

LONDON'S WATCHDOG, HOWARD DAVIES



OFF TO THE SALT MINES IN THE CITY



AGE 46

EDUCATION

Merton College, Oxford; Stanford Business School

PERSONAL

Married, two sons

CAREER

McKinsey & Co., 1982-87. Adviser to Chancellor of the Exchequer, 1985-86. Director General, Confederation of British Industry, 1992-95. Deputy Governor, Bank of England, 1995-97

STATE OF WEST VIRGINIA
DEPARTMENT OF ADMINISTRATION
BOARD OF RISK AND INSURANCE MANAGEMENT

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GOVERNOR

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June 3, 1997

Mr. Anthony Galioto, President
AIG Claim Services
70 Pine Street, 21st Floor
New York, NY 10270

Dear Mr. Galioto:

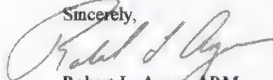
I have wanted to write this letter for some time. But, just as I would begin to write, AIGCS would again do something to impress me. Nonetheless, I did want to stop for just a moment and let you know how much we appreciate the outstanding service and cost savings AIGCS provides its clients.

Every encounter I have had with an AIGCS employee has left the impression that he or she is fully committed to the needs of their client's expectations. In today's business world, this should be a standard, but often, it is not.

Additionally, your commitment to continuous improvement enables your staff to work with clients to build relationships that support both parties in developing goals and objectives. As far as the West Virginia Board of Risk and Insurance Management (BRIM) is concerned, AIGCS is the standard by which we measure the other companies for service.

I hope you share this correspondence with your staff and with any prospective client who would be interested in an outside opinion of your service. Again, your professionalism and competence are very much appreciated.

Sincerely,



Robert L. Ayers, ARM
Chief Financial Officer

RLA:slb

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WORLD LEADERS IN INSURANCE AND FINANCIAL SERVICES

American International Companies, Dept. A, 70 Pine Street, New York, NY 10270 www.aig.com

EDITED BY JOHN TEMPLEMAN

HONG KONG'S DEMOCRATS ARE BUCKING TUNG'S REFORMS

Pro-democracy activists looked like the big losers in Hong Kong's reversion to Chinese sovereignty on July 1. They were shut out of the Beijing-appointed Provisional Legislative Council (Legco) that rules the newly created Special Administrative Region (SAR). Then, Hong Kong Chief Executive C. H. Tung began chipping away at old laws enshrining civil liberties. And on July 28, three Court of Appeal judges stepped down a challenge to Legco's legality.

But Hong Kong's pro-democracy critics of Beijing and Tung are no longer in retreat. Indeed, getting thrown out of the old Legco seems to have energized them. They have recovered the street smarts that helped them wrest concessions from the British. Now they are deploying them to rally public support against Provisional Legco bills. **LEGCO CAMPAIGN.** The campaign for Legco elections, due next May or June, has effectively begun and will be a far livelier and more open affair than Beijing planned. "The government is trying to prevent us from saying any voice, but public support for Legco keeps growing," says Democratic Party leader Minky Worden.

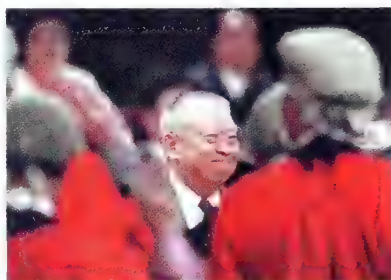
Political analysts say the democrats may not be sufficiently strong to win more than 20 of Legco's 60 seats. That would be a slap in the face for the government and Beijing and could cause serious headaches next year. Tung is trying to avoid such pain with a complicated electoral system that severely crimps opponents' chances of winning seats. Elections outlined in June would set at just 20 the number decided by universal suffrage. Another 30 are reserved to professional and corporate voters, with a final 10 appointed by an Election Council. The scheme, say analysts, is designed to limit opponents to as few as 12 seats.

Already, the democrats and their labor union allies are successfully driving a wedge into the pro-Beijing monolith in the Provisional Legco by picking hot-button issues. For ex-

ample, when Tung tried to get the legislature to annul five laws protecting labor rights, passed in the final session of the pre-handover Legco, opponents organized petitions and a hunger strike. Following their campaign, several of the old laws were upheld, while three relating to the right to organize were simply suspended pending further discussion.

Significantly, the episode prompted many Provisional Legco members to distance themselves from Tung. Legislators—from the pro-communist trade union grouping, the Hong Kong Federation of Trade Unions (FTU), the pro-Beijing Democratic Alliance for the Betterment of Hong Kong (DAB), and some members of the business tycoon-dominated Liberal Party—know they have to face the voters next year. So they don't want to look like mere rubber stamps in the service of Tung and the business leaders in his Cabinet.

Tung's tendency to treat the legislature in cavalier fashion is helping democracy groups widen the nascent split. Since assuming office, he has repeatedly asked Legco members to pass bills on short notice. Recently, for example, he gave them just one day to consider his nomination of



STYMIED: Legco rebuffed the boss

15 Court of Appeal judges.

It's a big turnaround since pre-handover times when Tung regularly admonished critics to "respect the Basic Law," the new Hong Kong's constitution. These days, opponents are throwing his advice back in his teeth as Tung tries to limit voting rights, repeal pre-handover laws, and pass restrictive new immigration laws. "The government has no respect for the Basic Law or even the rule of law, full stop," says ousted Legco democrat Emily Lau, "but next year it will be time for revenge." If voters agree with her, Beijing's promises to give Hong Kong wide autonomy will be put to a severe test next year.

By Dave Lindorff in Hong Kong

GLOBAL WRAPUP

BOMBS IMPERIL MIDEAST TALKS

The two deadly suicide bombs that ripped through West Jerusalem's Mahane Yehuda market July 30 will delay—and possibly derail—the meticulously orchestrated resumption of Israeli-Palestinian talks. The risk now is that both Israeli Prime Minister Benjamin Netanyahu and Palestinian leader Yassir Arafat could find themselves too weakened politically to move ahead with the peace process.

Netanyahu, elected 14 months ago on a security-first platform, is trapped be-

tween the Palestinians' mistrust and growing pressure from his natural constituency among Israel's political and religious right. Within hours of the bombing, right-wing Israelis demonstrated to demand Netanyahu's resignation. Arafat's administration is under unprecedented domestic attack for alleged widespread corruption. Besides, the Jerusalem bombing demonstrates that Arafat is still unable to control Palestinian extremists.

U.S. interests in the region could be damaged if the peace process went into limbo for long. Anti-American rhetoric

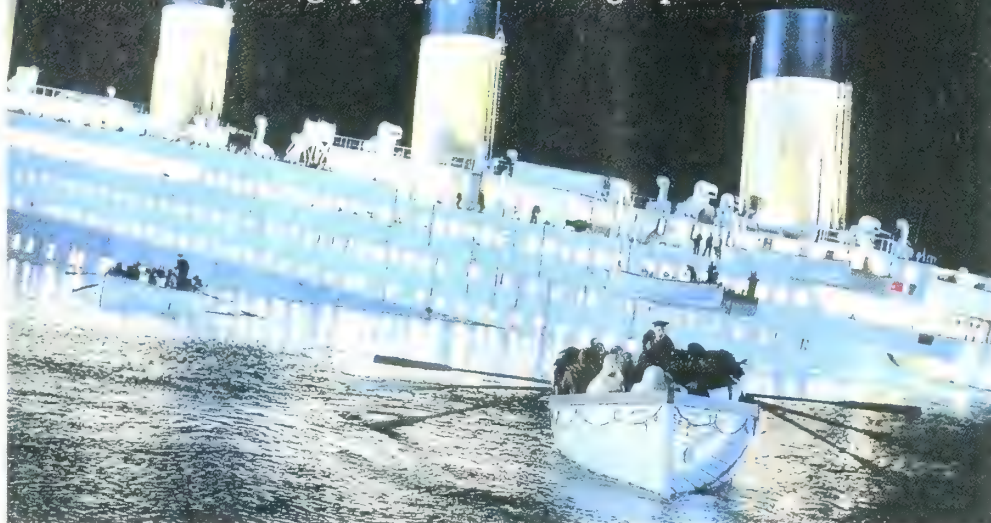
in the local press of traditional U.S. allies such as Egypt and Saudi Arabia is more extreme than at any time since the mid-1970s. Syria, once a part of the U.S.-led gulf war coalition, is mending fences with Saddam Hussein's Iraq. Oil-rich gulf countries—until recently the principal supporters of the U.S.'s anti-Iran policy—have similarly been moving to build bridges with Tehran. And almost all Arab states have pointedly refused to support U.S.-backed plans to convene a vast Middle East economic conference in Qatar in November.

By John Rossant in Rome

FILM FINANCING

MOVIE CRAZY ON WALL STREET

Investors are lining up to pay first and get paid last



Like Sandra Bullock's disaster-prone character in *Speed 2*, Twentieth Century Fox Film Corp. has spent the summer bouncing from one mishap to another. The studio, a unit of Rupert Murdoch's News Corp., released a pair of big-budget moneylosers in *Volcano* and *Speed 2*. To make matters worse, *Titanic*, with a budget approaching \$300 million, has been delayed from July 2 to around Christmas. Despite the flops, there's an eerie calm on the Fox lot. "We're not pushing any alarm bells around here," says one studio exec.

Why not? Fox, like many studios, is refining the art of using other people's money. The latest gambit sweeping through Tinseltown is "off-balance-sheet financing." In the past year, studios have raised more than \$2 billion by bundling up as an asset three years' worth of their entire slate of movies and shifting ownership of these films to outside investors. After five years, when revenues from overseas, video, and TV sales have been collected on those

releases, the studios buy the films from the outside investors.

It's a sweet deal for the studios. "We spend the largest amount of our resources on [moviemaking], the area that's riskiest," says one top exec of a major entertainment company. "That's pretty stupid." Now, with off-balance-sheet financing, they get to make movies at little financial risk and even recover most of their costs and collect big fees from the outside investors for marketing and distribution. And if any of the movies are hits, the studios still collect the lion's share of any net profits (table).

While it's clear why studios would

is raised, and none of the debt shows on their balance sheets. That's a huge boost for News Corp. and Universal, which are using freed-up capital to make other acquisitions. The debt is backed by Citicorp, which gets big fees and is positioned to do other studio deals.

This is nirvana for the studios. They get access to cheap money and the outside investors and banks have no power over how the movies get made. What's more, studios will recover most of their costs and collect those big fees, before outside investors see any net profit, which are often elusive in the movie business. And while banking industry sources

say Citicorp has told outside investors that the studios will refund some of these marketing and distribution fees in the event of a string of flops, misunderstandings commonly occur in the treacherous world of studio accounting.

So why do investors continue to line up? Citicorp declined to discuss its marketing pitch to name its clients. But sources familiar with the

FOX'S TITANIC: A budget of as much as \$300 million

Sweet Deals?

NEW COMPANY'S CAPITAL STRUCTURE

- 4% of equity capital is provided entirely by outside investors
- 96% of debt capital is guaranteed by banks

NEW COMPANY'S PAYOUT

- 4% of any net profits go to outside investors, after paying huge studio bills and debt service
- 96% of any net profits go to the studios, which don't invest any capital

s say Citicorp tells its investors that istically, each major studio will have monster hit over three years. Bank on the statistical probability of such a Citicorp forecasts a minimum annual rate of return of 15%. But the possibility that the studio will beat the odds deliver more hits is what's drawing stors. "There is always someone who ks they can do a little better by taking more risk," says New York financial planner Richard L. Jaffe, who hasn't the offering but wonders "why anyone would invest in the film industry." Both studios have already delivered hits for investors, with Fox's *Independence Day* for New Millennium and versal's *The Lost World* for Galaxy. How much the investors will actually is unclear. The marketing costs for films were huge, and *The Lost World* director Steven Spielberg took a piece of the studio's gross on the . Moreover, the huge profits from hits get put in the overall kitty, so profit from a monster hit like *Independence*, where outside investors' cut to date about \$16 million, is eaten away by es on expensive duds like *Speed 2*.

TY TIME. As long as Citicorp keeps money flowing, other studios can be ected to join the party. But so far, corp is the only bank to have sold ity to outside investors. Other banks issuing credit lines secured by a stu- s upcoming films. Sony and MGM are loring such deals, while PolyGram Time Warner Inc.'s New Line Cine- have recently closed deals worth hun- ds of millions.

Hollywood doesn't have the greatest rd with outside investors. Film-pro- tion limited partnerships flourished he mid-1980s, until a change in tax killed them off. But just last month, estors in one such decade-old limited nership sued Walt Disney Co. over much Disney paid the partnership ownership of 19 films that included o *Framed Roger Rabbit?* and *Three r and a Baby*. Such conflicts could nt investors in New Millennium and axy as well: After five years, Univer- and Fox must buy back films held the newly created companies. And t those movies will be worth by then ld be subject to dispute, though Citi- o's offering pegs the price tag to a nula tied to the film's revenues, not e subjective net profits.

Of course, studios don't like to talk ut such unpleasantness, flush as they with billions of dollars in fresh cash. e've learned that if you fleece your tner, there won't be many partners und after awhile," says Casey Silver, rman of Universal Pictures' film unit. now, they just keep coming.

By Ronald Grover in Los Angeles

The Corporation



DEALS

THE AVIS IPO: BUYER BEWARE

The upcoming offering is a sorry second to Hertz's deal

Rent-a-car giant Hertz Corp. went public in April, and for individual investors such as Roland Ott, Hertz has been one dreamy ride. An executive at SAIRGroup in Zurich, Ott bought 400 shares at the \$24 offering price and watched as they soared above \$39. In July, when the stock hit a rough patch, Ott sold out, bagging a profit of nearly 50% in 12 weeks. "I was very happy," he says, adding that he may look at Hertz's archrival, Avis Rent A Car Inc., which by October expects to sell stock of its own.

Mr. Ott, words to the wise: Proceed with caution.

Yes, both companies are in the car-rental business. And yes, the trend toward higher rates that is lifting Hertz also will buoy Avis. But Avis has designed a far different vehicle for public ownership. "Hertz is a very stable, well-managed company with modest leverage," says a Wall Street analyst who knows both rivals well. "Avis is a very risky, highly leveraged proposition."

The Avis stock offering would be the second major transaction for the company in less than a year. Last fall, the employee-owned company

sold itself for \$806.5 million to HFS Inc., a Parsippany (N.J.) creation of financier Henry R. Silverman. Franchisor of such businesses as Ramada hotels and Century 21 Real Estate offices, HFS has used a blitz of buyouts to multiply its revenues tenfold, to \$2 billion, in five years. Right now, HFS is awaiting an \$11 billion stock merger with mammoth marketer CUC International Inc.

MISSING PARTS. With Avis coming public again, neither HFS nor underwriter Bear, Stearns & Co. would discuss the deal in any detail. But a securities filing lays it out: HFS hopes to sell public investors 75% of Avis Rent A Car—ARAC for short—for \$225 million. Sound cheap?

Not when you read the filing and discover that ARAC is not what most people think of as Avis, the world's No. 2 car-rental concern, with 4,200 outposts worldwide all tied together by computerized reservations and management

systems. That network still exists, but Avis' key assets—its brand name, franchising operation, and computer systems—won't be part of ARAC. Instead, those corporate jewels will stay with HFS, where Silverman expects to ex-

Who Drives a Better Bargain?

	HERTZ FISCAL YEAR 1996	AVIS* FISCAL YEAR 1996
SALES (MILLIONS)	\$3,668	\$1,868
NET EARNINGS (MILLIONS)	\$159	\$5.8
PRETAX PROFIT MARGINS	7%	1.1%
PRICE/1996 EARNINGS	23	52**

*pro forma

DATA: COMPANY REPORTS

**indicated

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The Corporation

plot them across business lines. HFS, for example, could use Avis' Wizard reservations system to book rooms for its hotel chains.

So what's left for ARAC? It will be merely one of many Avis franchisees, albeit one with the right to run 414 high-volume outlets in the U.S.—and additional outlets abroad—that had been owned by Avis. Like any franchisee, ARAC will pay HFS for the use of the Avis name, initially at a rate of 4% of revenues. This year, that would work out to an estimated \$80 million—double what all of Avis netted in 1996.

HFS also can charge ARAC for other services, such as reservations and computer work. But allocating those costs could be tough, since many of those expenditures will also benefit the Avis assets that HFS will continue to own.

Avis has designed a stripped-down vehicle for its IPO. Investors won't be buying an intact worldwide car-rental system. They'll get only the assets Avis' current owner is slicing off

"Whatever HFS spends, they will rebill it to [ARAC]," says William Sider, Hertz's chief financial officer. ARAC will have its own management to look out for its interests, of course, but with a 25% stake and several directors on the board, HFS will have considerable influence.

These facts alone make shares in ARAC a sorry second to what investors got with Hertz (table, page 61). It remained intact when its majority owner, Ford Motor Co., sold shares to the public. Yet even on its own terms, stock in ARAC faces a cloudy future. That's because, judged several ways, the initial price HFS wants for ARAC seems inflated.

DO THE MATH. If the ARAC offering goes through as envisioned, Silverman's ledger would create \$300 million in market value for a chunk of Avis representing just 16% of its fair asset value. The trouble is, HFS paid \$806.5 million for the whole thing last fall. Do the math, and it implies a value today of nearly \$1.9 billion for all of Avis—a billion-buck leap in less than a year. An HFS spokesman declined to discuss how HFS valued ARAC.

Had ARAC been public last year, the filing shows, it would have earned \$5.8 million, implying a price-earnings ratio of 52. For Hertz, the figure is 23. Even if ARAC were to see earnings soar next year on rising rental rates and improvements made by HFS—to, say, \$16

million, as a Lehman Brothers Inc. report suggests—it would sell for nearly 19 times earnings. Hertz shares go for 16 times estimates of 1998 profit.

Since ARAC's structure differs so much from Hertz's, it may make more sense to value it as a rental franchise. One way to do that is to take a multiple of operating income, adjusted for interest expense and nonvehicle debt. Another method is to multiply the number of cars in a fleet by \$1,000. The first suggests a value for ARAC of \$207 million, the second, no more than \$196 million. Either way, concludes an executive at an Avis rival who has bought and sold many car-rental franchises, \$300 million implies "a multiple [much] higher than we would feel comfortable paying."

Assigning a value to ARAC is even more difficult because it has a tangle

net worth of negative \$120 million. What happened? A huge slug of debt and goodwill (an intangible asset) swamped the balance sheet. ARAC's goodwill—accounting lingo for the premium HFS paid last year over the fair market value of Avis' assets—came to \$197 million, or 59% of the total goodwill HFS created in buying Avis. Yet the new company got just \$75 million, or 16% of Avis' fair asset value. All that goodwill could cast a shadow over ARAC's future earnings, since it must be written off over 40 years. If the amount of goodwill turns out to be excessive, the company could have to accelerate the write-off, hurting earnings even more. HFS notes that it follows generally accepted accounting principles.

Of course, one reason ARAC shares look expensive is because of the hard bargain Silverman drove when HFS bought the company last fall. The market values Hertz at about one times its sales. On that basis, an intact Avis is worth about \$1.9 billion, vastly more than HFS paid for it. The problem for investors is that they aren't getting an intact Avis. They're getting the part Silverman has chosen to slice off. Knowing that, Roland Ott and other investors may want to think twice before getting on the other side of a deal with HFS.

By Robert Barer

In the World of High-Tech, Change Happens Fast.

Now There Are Two New Ways to Get Up to Speed.

Business Week

*A special report on
Silicon Valley in the
August 18-25, 1997
double issue*

*On-line for two weeks
beginning August 8, 1997*

CNBC

*Complementary coverage of
Silicon Valley for two weeks
beginning August 4, 1997*

*Check local listings for
channel number and time*

This summer Business Week and CNBC are teaming up to provide a comprehensive and timely look at the phenomenon that is Silicon Valley. In its August 18-August 25 special double issue, Business Week will explore the past, present and future of this vaunted slice of Northern California. Beginning August 4 and running for two weeks, CNBC will pick up where Business Week leaves off, with complementary coverage in segments throughout the day.

Both Business Week and CNBC will talk to the people who put Silicon Valley on the map and examine how the unorthodox business culture born here has increasingly become the model for Corporate America. Other technology hot-spots around the globe, some already well-known, others likely to become household names, will also be featured in these special reports.

The world is changing; don't get left behind.



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WANTED: A FEW GOOD CEOs

Why managing succession is such a problem
—and what companies ought to do about it

If you are planning for one year, grow rice. If you are planning for 20 years, grow trees. If you are planning for centuries, grow men.

—A Chinese proverb

Well, it is only a proverb, and maybe one best suited to a fortune cookie. Don't expect to find it as a statement of purpose in many executive suites today. With the revolving door at the top of Corporate America spinning faster than ever, the days when corporations spend

bers: Of the 500 companies in the Standard & Poor's index, 17% have CEOs who are 63 or older. According to Bain & Co., that's up from only 10% in 1993.

Already, headhunters are scouring the landscape for new chiefs at AT&T, Apple, Delta Air Lines, Raytheon, Quaker Oats, and Unisys. Close behind are a host of other corporate powerhouses that will soon have to decide who is most qualified to fill the CEO shoes. For such high-profile companies as Walt Disney, Ford Motor, IBM, Coca-Cola, Citicorp, and General Electric, the question of succession is imminent and ongoing.

But how best to choose a new CEO? In the wake of one succession shuffle after another, it is fast becoming a major focus in management circles. In September, the National Association of Corporate Directors will convene a blue-ribbon panel to explore how boards should approach the issue. McKinsey & Co., the tony consulting firm, has just embarked on a major re-

Cover Story

countless hours and millions of dollars cultivating legions of executives for the top job are fast disappearing. As Gilbert F. Amelio's abrupt exit at Apple Computer or John R. Walter's surprise resignation from AT&T make clear, CEO succession has become a messy melodrama. And few companies seem to have the time, the luxury, or the patience to grow CEOs anymore.

Yet there are few management issues of greater importance to companies, their investors, or their employees than who will lead a corporation in the future. The recent blowups underscore the imperative for CEOs and their boards to do a better job of preparing for succession. And as the generation of executives whose careers began in the postwar years hits retirement age, the issue will play out in record num-





SUCCESSING AT SUCCESSION

Here's a list of "best practices" from companies with a reputation for skillfully grooming managers for the top job

► The CEO and the board communicate once or twice a year on who would take over in a crisis, reviewing their choices as the company's strategy shifts

► The board is deeply involved in succession

► Directors periodically review internal candidates against comparable outsiders

► All potential inside candidates meet regularly with the board, both in business and social settings

► Chief executive pay is tied to the development of succession plans

► Next-generation CEOs are encouraged to accept an outside board assignment, and get exposure to the media and investors

► The company runs the drama of succession by reducing horse among top contenders

► The CEO nurtures a succession culture which promises to be given jobs to broaden their

search effort dubbed "The War for Talent" to study the best practices in the recruitment, development, and retention of a company's talent pool.

Much of the spotlight on CEO succession comes in the wake of the bloody dustups that have filled the business pages of late. But in recent years, there also have been major changes in the way succession is planned and executed. In part, that's due to pressure from institutional shareholders. The massive downsizings that have weakened the bench strength of many companies have also played a role. They've made companies far more willing than before to go outside their ranks for a new CEO. Back in the

loitte & Touche Consulting. "Today, the onus for developing and finding a successor has moved to the board."

Of course, boards are hardly fail-safe either. Apple's directors now have three failed CEOs to their credit. But with the shift, many boards are redefining their own roles, as well as rethinking how much involvement the CEO should have in naming his or her replacement. They are taking more responsibility for the

timing of the boss's exit, making succession planning a component of the CEOs yearly performance review, and in many cases, debating what is the right division of labor between the board and the outgoing chief. "When a CEO and the company are doing very well, he tends to get the benefit of the nod," says Richard L. Thomas, former chairman of First Chicago NBD Corp. and a director on several boards. But if the CEO is on the rocks himself, "the board tends to be more assertive."

Ideally, say observers, outside directors should control the succession process, interviewing all internal candidates for the top job and hiring a search firm to benchmark insiders against the best outside talent. "The most important thing a board has to do is to decide who has to run the place," says John H. Bryan, CEO of Sara Lee Corp. and a director at Amoco, First Chicago, and GM. "I have been on boards for almost 20 years, and the attention given to this is vastly ahead of what it used to be."

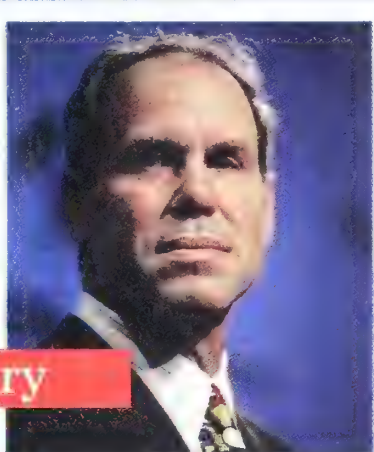
For many companies, it's a top-of-mind concern. GE Chairman and CEO John F. Welch, who plans to retire in 3½ years when he turns 65, refuses to publicly discuss his much watched succession with U.S. reporters, but he recently told the French magazine *L'Expansion* that the issue has become a "obsession" for him. "It's on my mind constantly," said Welch. "Finding the right person is the most important thing I can do for the company."

TAILSPIN. At GE, there are roughly 10 a dozen serious candidates for Welch's job. But at the vast majority of corporations, there are far fewer, if any, local internal successors. Most observers agree that if something happened to Microsoft Corp.'s William H. Gates III or Walt Disney Co.'s Michael D. Eisner, the stock of those companies would go into a tailspin. Yet Eisner—who has lost three potential successors, one death and two to blustery public res-

Cover Story

late 1960s, only 9% of new leaders came from outside. Now, nearly a third of CEOs at the top 1,000 public companies are outsiders—and that number is likely to grow.

But the biggest change may simply be the influence directors now wield in the process. Choosing a successor was once the near-exclusive province of the outgoing boss, who would present his pick to a generally compliant board. Now, outside directors at companies ranging from Campbell Soup to Merck and General Motors are taking a far bigger hand in selecting the new boss. In a few notable cases, boards are even taking charge. "In the past, there was a huge onus on the CEO to groom his own successor," says Susan Gretchenko of De-



★ **MICHAEL EISNER 54**
CHAIRMAN AND CEO, WALT DISNEY
RETIREMENT DATE: NONE

Since President Michael Ovitz quit in December, 1996, there's no obvious successor to Eisner, who had heart bypass surgery in July, 1994.



★ **ROBERTO GOIZUETA 65**
CHAIRMAN AND CEO, COCA-COLA
RETIREMENT DATE: NONE

Although President and COO M. Douglas Ivester is thought to be Coke's heir apparent, the board asked CEO Goizueta to stay on indefinitely in 1996. Goizueta has refused to state publicly that Ivester is his choice.

Some boards insist that progress in succession planning

company cre-
executive group
al CEO candi-
d makes them
the chal-
business plans,
regies across
rization

SPENCERSTUART

side and outside" Disney who could
e over, he concedes the company has
concrete succession plan.
just what would happen at Disney
l many other companies remains an
gma, in part because passing the ba-
to a new leader is fraught with risk
l emotion. Most companies sidestep
r talk of the boss's succession, partly
avoid the politics and drama that of-
engulf contenders for the top job.



★ **ALEXANDER TROTMAN** 64

CHAIRMAN AND CEO, FORD MOTOR
RETIREMENT DATE: JAN. 1, 2000

Board member William Clay Ford Jr.
and Automotive President Jacques
Nasser are being groomed for the
Chairman and CEO slots,
respectively. But with neither yet
ready to step up, the board extended
Trotman's contract last March.

er all, public horse races can en-
rage ruthless elbowing among com-
itors, even as they advertise talent to
wling headhunters and rivals.
In testing his potential successors,
s Welch has vowed not to repeat the
y public process of elimination that
had to go through to become chair-
man and CEO in the late 1970s. Then,
Welch was among seven top execs, a
of whom were later named vice-
firmen and placed on the board until
Welch was declared winner 14 months

nations—seems annoyed at the talk
about who could assume his job. "I
am 54 years old, and if it hadn't
been for my by-
pass no one would
be even talking
about succession,"
says Eisner. While
he says there are
a handful of people

later at the end of 1980. "He felt it was
divisive," says Noel M. Tichy, a Uni-
versity of Michigan professor who has
worked with Welch. "People naturally
took sides, and it created armed camps
at the company." The scramble also cost
GE precious talent: Immediately after
being bypassed, four candidates left GE.

In that area now, GE is in a rare po-
sition. It boasts such bench strength
that it has become a favorite poaching
ground for headhunters. Indeed, GE
dominates a BW survey ranking execs
with CEO potential (page 69). Elsewhere,



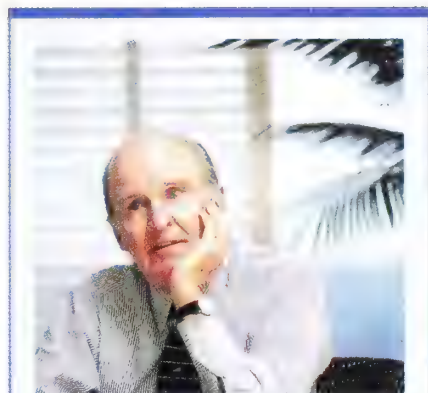
★ **JOHN REED** 58

CHAIRMAN AND CEO, CITICORP
RETIREMENT DATE: FEB., 2004

Critics say Reed has pushed out
some talented executives as they
have risen, so that no strong No. 2
has emerged. No clear successor is
in sight.

though, a paucity of executives with the
right stuff has increasingly become the
norm, putting pressure on boards to
move quickly when they have a credible
successor in-house. After all, in today's
fluid market, the risks of having your
top candidate plucked off are high. At
H.J. Heinz Co., for example, Wall
Street analysts publicly fret that
the food company could lose
President William R. Johnson
to Quaker Oats Co. or another
rival if longtime Chairman and
CEO Anthony J. F. O'Reilly fails
to retire in a timely fashion.

At other companies, the
CEOs contract has been ex-
tended past original retire-
ment dates because of un-
certainty about succession.
Sometimes, the CEO is unwill-
ing to give up the corner of-
fice; elsewhere, boards feel no
one is ready to step up. In the
past year, boards at Avon,



★ **JACK WELCH** 61

CHAIRMAN AND CEO, GENERAL ELECTRIC
RETIREMENT DATE: NOV., 2000

The race to succeed Welch is on
between several internal
candidates. Succession plan is
well developed and well regarded.

Coca-Cola, Gillette, and Ford have ex-
tended the contracts of CEOs past 65,
their customary retirement dates.

Uneasy because some chieftains have
paid scant attention to succession, some
boards have now tied the process to
CEO pay. At Ralston Purina Co., the
board handed Chairman and CEO Wil-
liam P. Stirtz 600,000 stock options last
year expressly linked to his developing
a succession plan. The board "did not
see an obvious successor in place," says
Eric P. Marquardt, a senior vice-presi-
dent at Compensation Resource Group
Inc., which designed the plan. The re-
sult: Stirtz named two co-CEOs who will
take over Sept. 30, when he will relin-
quish the job but stay on as chairman.

If Stirtz, 63, has dragged his feet,
he's hardly alone. Confronting one's
own succession can be daunting to
the ego. "It's a little like writ-
ing a will," says Dennis C.



Carey, vice-chairman
of SpencerStuart, who
has co-authored a
forthcoming book on the
subject. "Most CEOs don't want to
think about it. They're consumed
with the business and don't want

of the annual review of the boss's performance

to consider their own mortality."

Business history is littered with CEOs who don't know when it's time to call it quits. Today's Harold S. Geneen or Harry Gray—both corporate architects who had to be pushed out by their respective boards at ITT Corp. and United Technologies Corp. after they allegedly sabo-

Cover Story

tagged several potential successors—may well be Steven P. Jobs at Apple or John S. Reed at Citicorp. Jobs is now playing an ever larger role at the troubled computer company he co-founded. Unwilling to step completely aside, his presence complicates Apple's already difficult search for a new CEO. Meanwhile, the 58-year-old Reed has pushed out some of Citicorp's most talented executives; critics believe he has done so to ensure that no strong second-in-command emerges. The void led to a shareholder resolution last April urging Reed to name a clear successor. Although the resolution failed, a Citicorp spokesman says that Reed



★ **ROBERT CRANDALL** 51

CHAIRMAN AND CEO, AMR
RETIREMENT DATE: NONE

Crandall rode out tumultuous contract negotiations and a brief pilots' strike. Has named American Airlines President Donald Carty as heir apparent but says only that he'll retire before age 65.

has brought several overseas executives to New York headquarters to give "broader experience to a new generation of management."

Yet while many companies stall in the face of inevitable transition, others have begun to develop new ways of maintaining a steady supply of CEOs-in-waiting. The goal is to cultivate talent and expose it to the board and the outside world, leading to an array of "best practices" that are gaining increasing acceptance (table, page 66).

The recent passing of the torch at

Campbell Soup Co. may well rewrite the book on CEO succession. It is an unusual example of a board that took full charge of the process. The company elevated Dale F. Morrison, head of its international and specialty food operations, to CEO and president on July 15. To assure a smooth transition from 64-year-old Chairman and CEO David W. Johnson, the board assembled a succession committee in November of four outside directors headed by Philip E. Lippincott, the former chairman of Scott Paper Co. The group quickly decided to evaluate not only the two best inside candidates—Morrison and U.S. grocery President Robert F. Bernstock—but also to hire Thomas J. Neff of search firm Spencer-Stuart to round up the best outsiders.

The committee narrowed its external search to three final candidates from Neff's initial list of 19 outsiders. After interviewing the three, directors sent two of them to CEO Johnson before deciding on a single outside finalist. Lippincott also insisted that Neff do an unusually large number of reference checks—28 altogether—on the two outside finalists. "When you have really good inside people, you want to be sure that if you pick an outsider, it's somebody highly respected," says Lippincott.

Meantime, the committee interviewed both Morrison and Bernstock on three occasions and arranged for small groups of other outside directors to question them as well. The committee also grilled the seven execs who report directly to Johnson to get their impressions of the two insiders, and it arranged for headhunter Neff to interview Morrison, 48,



★ **ALFRED ZEIEN** 67

CHAIRMAN AND CEO, GILLETTE
RETIREMENT DATE: NONE

Though COO Michael Hawley is expected to replace him, Zeien shows no signs of packing up. The board has extended his contract for three straight years and paid him bonuses to forgo retirement.



★ **WILLIAM SMITHBURG** 59

CHAIRMAN AND CEO, QUAKER OATS
RETIREMENT DATE: WHEN SUCCESSOR NAMED

Search now under way for CEO to replace Smithburg, who announced plans to resign following Quaker's ill-fated acquisition of Snapple.

and Bernstock, 46, for Neff's assessment.

In mid-June, after a private session with Johnson to get his review of the year-to-date progress of the internal candidates, the committee weighed two insiders against the outside candidate. Although Morrison has been at Campbell for only two years, directors were especially impressed by the former PepsiCo Inc. executive's turnaround of the company's Pepperidge Farm business. Morrison, moreover, had lived outside the U.S. for six years, a key advantage because international growth is central to Campbell's strategy. On June 26, the group unanimously recommended Morrison. Three days later, the full board approved the choice.

All told, the outside directors met 11 times from early December to June and communicated by phone more often. "I felt I was no longer retired," says Lippincott. "But it's the most important job a board has. You have to be sure you have the absolute best person to take the organization to the next level."

EMPTY TALK? There, as elsewhere, a huge change may be the willingness of major companies to look outside their own ranks. While many companies do devote significant effort to grooming and-coming execs, a decade of downsizing has drained a lot of talent from the pool. It has also cut layers of management where high-potential executives once gained additional seasoning.

Some observers, in fact, now say that rapid changes in business and a multi-job market have made much of the old management development superfluous for the run-of-the-mill company. "Unless you're GE or somebody like that, it may no longer make economic sense to make major investments in

development and training," says Robert Alton, a McKinsey & Co. partner. Companies should think twice about sending a lot of time and money on someone who may walk out of the doorway. A healthier attitude today may be to consider the world as your bench." That's still an unusual view, one prompted in part by the inability of IBM and AT&T—companies that have spent

more money and time on management development than most—to cultivate internal CEOs. "They prepared a wonderful group of executives for yesterday's business," says Edward E. Lawler, director of the Center for Effective Organizations at the University of Southern California. "By being so good at narrowing the gene pool, they replicated people who would have been good lead-

ers in the past but not the future." It didn't help, of course, that both corporations had monopolistic mind-sets as well as more narrow product lines. In contrast, GE's portfolio of businesses, ranging from hard-core industrial manufacturing and consumer-goods marketing to finance and broadcasting, has long provided broader developmental experiences for its executives. The compa-

THE TOP 20 HEADS TO HUNT

No one likes to see talent walk out the door. But Jack Welch may have little choice. Once he appoints his successor as chairman and CEO of General Electric Co., he's likely to face an exodus as the runners-up ditch GE for top slots elsewhere.

That's the word from the country's leading executive-search consultants. BUSINESS WEEK asked the top 25 general management recruiters, as ranked by headhunter John R. Sibbald in his book *The New Career Makers*, for a list of execs likely to

become CEOs at a major corporation within five years. We asked them to leave off such well-known No. 2's as Coca-Cola's M. Douglas Ivester and American Airlines' Donald J. Carty, who are acknowledged heirs apparent. In all, 20 recruiters named 133 candidates, from which we compiled a top-20 all-star list.

"ONLY ONE." The company with the most names? Good old GE, with five of the top 20 and nine altogether. Recruiters say the GE picks—David L. Calhoun, W. James McNerney Jr., Ronald L. Nardelli, Gary L. Rogers, and Robert C. Wright—will be hot commodities no matter what. "Only one guy can get Welch's job," says John F. Johnson, chairman of headhunter Lamalie Amrop International, "and that will unleash a tidal wave of CEO candidates."

There's a tinge of irony here. In a culture where few companies

successfully cultivate internal leadership, those that do often lose top talent to companies in need of a savior. Says E. Pendleton James of Pendleton James & Associates Inc.: "GE is a farm team for us headhunters."

The top vote-getter is McNerney, 47, CEO of GE Lighting. A former McKinsey & Co. consultant, McNerney has run business units, such as GE Information Services, as well as the Asia Pacific operations in his 15 years at GE. "He has it all: He has the boardroom presence. He's hand-

some. He definitely has the smarts," says Daniel M. Shepherd of Chicago's Shepherd Bueschel & Provus.

Close behind is Kenneth I. Chenault, president and chief operating officer of American Express Co. Also an ex-consultant, Chenault has run the card group and led a restructuring that cut \$2 billion in costs. Headhunters prefer Chenault's and McNerney's all-around leadership to narrow experience. Jay Gaines, president of search firm Jay Gaines & Co., says CEOs-to-be should excel in three

areas: They must be capable of managing technology. They should be able to build the relationships prized in sales and marketing. And they need a solid operating record. "If you don't run a unit," says Gaines, "it's extremely rare to get to the top."

Indeed, most of our picks have run or are running a business of their own. At PepsiCo, Craig E. Weatherup is CEO of its Pepsi-Cola division, while Steven S. Reinemund runs Frito-Lay. Lois D. Juliber now heads all of North America and Europe for Colgate-Palmolive. And Samuel J. Palmisano built IBM's computer services group into a \$16 billion behemoth.

At a time when boards bemoan the lack of top talent, few are complaining about this group. If their bosses don't keep them happy, they may soon be heading for the door.

By Jennifer Reingold and John A. Byrne in New York

CEOs-IN-WAITING?

These 20 execs could soon emerge as CEOs of major corporations.

NAME	AGE	COMPANY	TITLE
RICHARD BELLUZZO	43	HEWLETT-PACKARD	EXECUTIVE VP
JAMES BERGES	50	EMERSON ELECTRIC	VICE-CHAIRMAN
LESLIE BILLER	49	NORWEST	PRESIDENT, COO
JOHN BOWLIN	46	KRAFT FOODS INT'L	PRESIDENT, CEO
DAVID CALHOUN	40	GE TRANSPORTATION	CEO
KENNETH CHENAULT	46	AMERICAN EXPRESS	PRESIDENT, COO
JEAN-PIERRE GARNIER	49	SMITHKLINE BEECHAM	PRESIDENT, COO
LOIS JULIBER	47	COLGATE-PALMOLIVE	EXECUTIVE VP
RICHARD MCGINN	50	LUCENT TECHNOLOGIES	PRESIDENT, COO
W. JAMES MCNERNEY JR.	47	GE LIGHTING	CEO
LEO MULLIN	54	UNICOM	VICE-CHAIRMAN
ROBERT NARDELLI	49	GE POWER SYSTEMS	CEO
SAMUEL PALMISANO	44	IBM	SENIOR VP
FREDERIC POSES	54	ALLIEDSIGNAL	EXECUTIVE VP
STEVEN REINEMUND	49	FRITO-LAY	CHAIRMAN, CEO
GARY ROGERS	52	GE PLASTICS	CEO
MARC SHAPIRO	50	CHASE MANHATTAN	VICE-CHAIRMAN
RAYMOND VIAULT	53	GENERAL MILLS	VICE-CHAIRMAN
CRAIG WEATHERUP	51	PEPSI-COLA	CHAIRMAN, CEO
ROBERT WRIGHT	54	NBC	CEO

DATA: BUSINESS WEEK

nies' depth of talent is evident in the number of GE-trained executives who are now CEOs at other companies, from AlliedSignal and Owens-Corning to McDonnell Douglas and Stanley Works.

That's one reason the most closely followed succession in American business will be at GE. Insiders say that

Cover Story

Welch has been testing more than a dozen CEO aspirants by rotating them through numerous assignments and giving them frequent board exposure. The leading contender—according to outside handicappers—is W. James McNerney Jr., one of several fortysomething stars in the company's stable. A Harvard MBA and former McKinsey consultant, McNerney, 47, came up through GE Capital, did three years in Asia, and became president of GE Lighting in late 1995.

CRASH COURSE. Welch has not put candidates through the now-infamous "airplane interviews" that his predecessor, Reginald H. Jones, used to sort out candidates. In those sessions, Jones abruptly called each contender into his office and asked who should be the next chairman if both were on the company plane and it crashed. "It's so much a part of the company's folklore that it wouldn't get the same spontaneity," says a GE executive.

While GE may remain in the forefront of management development, many other companies are investing big bucks and lots of time systematically grooming successors. Whirlpool Corp. has created what insiders there call "the bunker," a 15-by-25-foot room dedicated to tracking the progress of its top 500 managers. The four walls of the locked room are divided by regions of the world and contain the names, titles, and photos of the company's key talent. Whenever executives enter the room, any topic other than management development stays outside. "It's really made us much more focused during succession discussions," says Ed R. Dunn, corporate vice-president for human resources.

At Corning Inc., the CEO and the board meet every February for a discussion devoted entirely to officer-level succession issues. A week before the session, directors are given books that detail top candidates for key jobs: those ready now, good possibilities for three to five years out, and the long shots who may need up to a decade of seasoning. "The more time you spend on succession planning and having the board involved, the better," insists Chairman and CEO Roger G. Ackerman.

Years ago, companies pushed promising candidates up every 16 to 20 months,

often through a single function. Today, there's greater emphasis on broader experiences over longer periods of time. "We ideally follow a two-plus-two-plus-two formula in developing people for top management positions," says Dan Phelan, senior vice-president and director of human resources at SmithKline Beecham Corp. Translation: The company wants its best people to gain experience in two business units, two functional areas such as finance and marketing, and two countries. Every time a vacancy opens among the top 300 jobs, it will consider the possibility of looking outside for talent. "A little new blood doesn't hurt," says CEO Jan Leschly. "If you're not the best person for the job, we'll show no hesitancy to go outside."

And what if disaster strikes? Planning for the unplannable is part of the



★ **RONALD ALLEN** 55

CHAIRMAN AND CEO, DELTA AIR LINES
RETIREMENT DATE: JULY 31, 1997

Allen was ousted by the board in May after cost-cuts alienated workers and hurt morale. An interim CEO was named in July, and an outside search for a new CEO is under way.

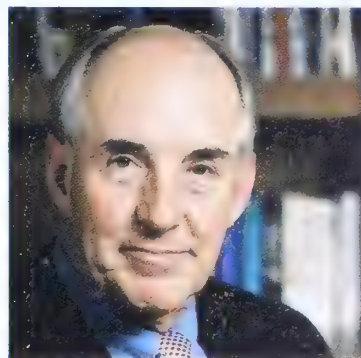
process. Every year, Leschly meets with the board's remuneration and nominations committee to detail long-term succession plans, including who would follow if he were "hit by a truck."

Sometimes it takes a debacle for a company to become more systematic about choosing a new leader. After a contentious succession struggle at United Technologies in the mid-1980s over Harry Gray's refusal to leave, newcomer Robert F. Daniell pledged to ensure an orderly succession process the next time. He developed several internal candidates, giving them broad exposure to the board. "Daniell created a group of a half-dozen of us who went to every board meeting beginning in 1987," says current CEO George David.

After winning a three-year horse race between two executive vice-presidents, David was named president in early 1992, CEO in 1994, and chairman in April

after Daniell's retirement. "From the time I was named president, Bob never allowed any ambiguity about succession whatsoever," says David. "Politics in organizations occur when there is ambiguity and uncertainty."

Still, for every board trying to tackle CEO succession in a head-on fashion, there



★ **WILLIAM STIRTZ** 63

CHAIRMAN AND CEO, RALSTON-PURINA
RETIREMENT DATE: SEPT. 30, 1997

After 15 years on the job with no obvious replacement, the board offered Stirtz a deal: He swapped short-term pay for a huge option grant to focus on finding a successor. He has named two co-CEOs to replace him but will remain chairman.

remain many who leave it until too late or in the wrong hands. "The biggest single problem of boards of directors is that they are terrible at noticing when a CEO has stopped doing well," says M. Minow, principal of Lens Inc., the activist investment fund. AT&T is an obvious example, with the company and its shareholders now paying the price. By allowing Robert E. Allen to control the outside search for his successor—even his refusal to gracefully exit the CEO spot prevented the company from attracting a top-drawer candidate—AT&T may have doomed the process from the start. The board, sources say, met no other candidate for the job except Walter, the head of R.R. Donnelley & Sons Co. Embarrassed by Walter's resignation after only nine months, directors say they are now conducting the search for a new CEO.

Truth is, you don't have to plan centuries to groom a successor. Its shareholders need active and involved boards attuned to the leadership needs of their companies. The sudden demise or departure of a CEO shouldn't confound an enlightened and prepared board.

By John A. Byrne and Jennifer Reagold in New York, with Richard Melcher in Chicago and bureau reports



transistor, Bell Labs '47



56 Kbps modem chip set, Bell Labs '97

CHIP off the old block.
(couldn't resist)

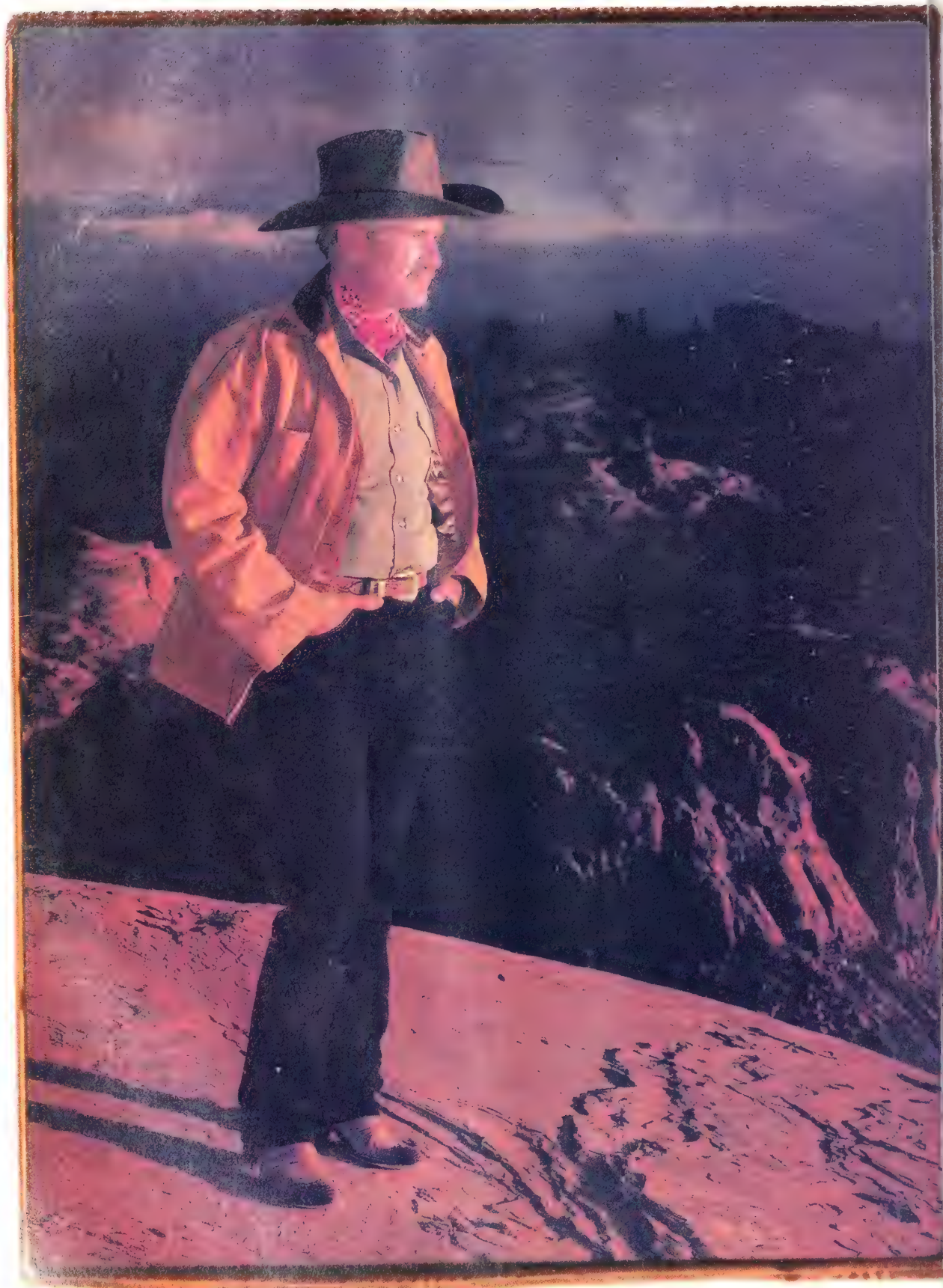
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TOYOTA People Drive Us

COMMERCIAL FINANCE

BAD DEBTS, SWEET PROFITS

Never heard of CFS? It's reaping eye-popping gains from delinquent credit-card loans

From his 55th-floor perch adjacent to the Oral Roberts University campus, William R. Bartmann is already plotting his next extravaganza. If June and July revenue targets are met, he will fly 4,500 employees and guests to Las Vegas in September for a mud-wrestling match: Bartmann vs. one of his top executives. The following month, he plans to take employees, filling 200 train cars, to a baseball game in Kansas City, Mo.

It's vintage Bartmann: big, bold, and flamboyant. The 48-year-old entrepreneur has followed the same path in building Tulsa-based Commercial Financial Services Inc., now the nation's biggest purchaser by far of delinquent credit-card debt written off by banks and other issuers. CFS buys the debt, then pools and sells it to institutional investors, while retaining and collecting on the accounts. **"POLITE PERSISTENCE."** CFS has revolutionized the collection business. Bartmann was the first to securitize soured credit-card debt. And he has brought leading-edge technologies to what has been a mom-and-pop business. Using what one analyst calls "polite persistence" with debtors, Bartmann and his 2,350 employees—up from only 17 in 1990—collect far more than CFS pays for its accounts. "We don't think we have any competition at the moment," says Bartmann. Twelve-year-old CFS

now manages a portfolio of about 2.5 million accounts with a face value of almost \$8 billion, primarily credit-card charge-offs. CFS claims it will have 43% of the Visa/Mastercard charge-offs taken this year by the top 25 issuers while rivals have 1% to 2%.

So far, the emerging industry has proven wildly profitable for privately held CFS, of which the Bartmann family owns 80%. Last year, the company earned \$137 million on revenues of \$206 million. That's a huge net margin of 67%, mainly because CFS sells loan pools



"WE'RE GOING PLACES"
CFO Bartmann turned
down a \$1 billion offer
for his company. He'll
soon expand overseas

for far more than it pays. There is still plenty of business to tap as issuers see big advantages in selling their charge-offs: instant cash and reduced collection expenses.

Still, Bartmann's aggressive purchases and his company's supersonic growth have raised eyebrows among competitors. CFS this year will spend about \$600 million to buy charge-offs with a face value of some \$7 billion, more than double the volume of his closest competitors. Rivals contend that CFS grabs business by paying steep prices for charge-offs: as much as 10¢ on the

dollar for freshly charged-off debts, 20% to 50% more than competing buyers. And CFS is aiming eventually to collect 30¢ on the dollar vs. the 15¢ to 18¢ major banks get. Critics say CFS won't be able to collect anywhere near its lofty estimates and may leave investors in a lurch. After all, the market for charged-off receivables is still relatively new, and buyers such as CFS have yet to face a severe economic slump. "It's possible for them to do what they say they do, but not easily," says Scott Lowery, president of Denver-based rival Collect America.

CFS, which has focused primarily on credit-card debt for less than two years, says the prices it pays for bad debt

ed by years of collection data fed computer models that it uses to its bids. And it enjoys key advantages over collection agencies working for a fee. As an owner of the accounts, CFS has more flexibility to cut deals with debtors to get settlements. And it has some accounts for as long as several years.

Optimists don't faze a tanned, trim man, who's planning still bolder moves. He'll soon open a London office and jump into the European debt market. In January, he plans to start a subsidiary to lend to current CFS "customers," as debtors are called internally. The accounts of customers who

the structure of the deals "adequately insulates the investors so far," agrees Sean P. Sheerin, a vice-president at Duff & Phelps Credit Rating Co.

Investors seem content. "So far they have met their projections on collectability, but it's still early in the process," says Jennifer O. Quisenberry, vice-president at Structured Finance Advisors Inc., which has represented eight institutional investors in Bartmann's securitizations. Investors are lured by a yield that's about 215 basis points over Treasuries, vs. 100 to 150 on comparable investments with a 2½-year average life, says Quisenberry.

CFS's success, though, is attracting

and ensure a constant flow of "inventory" for CFS. "If you want to come in and compete, you have to live off that which we don't have," brags Bartmann. More important, he says, is CFS's reputation for ethical dealings in an industry still plagued by abusive and questionable tactics—a claim rating agencies generally support. Banks are leery of handing over their customers—even bad ones—to companies that might hurt the banks' reputations.

There's no denying that Bartmann has built a powerful collections machine since he and his wife, Kathryn, first started collecting on nonperforming Federal Deposit Insurance Corp. loans in 1986 from their kitchen table in Muskogee, Okla. Along with partner Jay L. Jones, the couple changed their focus to credit-card debt as bank failures dwindled.

Bartmann credits CFS's success to careful screening and lengthy training of employees, who are then armed with the best technology in the business. CFS will spend about \$60 million this year on hardware, software, and development, overseen by a 75-person information technology department. CFS has a sophisticated "skip tracing" system that tracks down debtors who have moved or changed phone numbers by electronically searching more than 50 databases. Automated phone dialers "learn" the patterns of different accounts so they can call when debtors are likely to be home.

But Bartmann and backers say CFS goes beyond machines to a philosophy of respect for people. After finding himself \$1 million dollars in debt when his oil-

field pipe company went belly-up in the 1986 oil bust, he seems to understand the psychology of debtors. "You've got to be sympathetic; you've got to listen with your heart as well as your head," Bartmann says the script for his collectors ends with "Now what can we do?"

MISSION RISK? So far, Bartmann's wire act is a hit on Wall Street. Nine of his securitizations have won A credit ratings from Standard & Poor's Corp. Lily Cheung, a director at JP, believes that the securitizations are substantially overcollateralized—Bartmann's estimated recoveries on portfolios far exceeding what he offers investors. While a recession could trigger a substantial drop in collections,

growing numbers of rivals. Indeed, Bartmann's dominance could work against him, as credit-card issuers look for ways to ease their dependence on a single buyer. "I would envision the biggest competitors [to CFS] being the banks themselves," says Stewart J. Reale, senior vice-president of First Union Corp., which sells charge-offs to CFS.

Still, the barriers to entry are increasingly formidable. CFS has exclusive or near-exclusive "forward-flow" agreements to buy charge-offs at a predetermined price from 15 of the top 25 bank credit-card issuers, locking out competitors for one to five years. The deals lower administrative costs for the banks

and ensure a constant flow of "inventory" for CFS. "If you want to come in and compete, you have to live off that which we don't have," brags Bartmann. More important, he says, is CFS's reputation for ethical dealings in an industry still plagued by abusive and questionable tactics—a claim rating agencies generally support. Banks are leery of handing over their customers—even bad ones—to companies that might hurt the banks' reputations.

For Bartmann and CFS, the answer, so far, seems to be almost anything. Indeed, Bartmann claims that in recent months he turned down a \$3 billion cash offer for the company. Why? "It wasn't enough. We're going places," he says. His investors and credit-card partners certainly hope so.

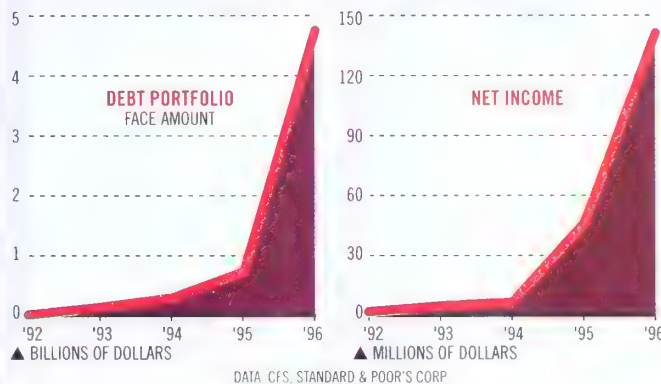
By Wendy Zellner in Tulsa and Phillip L. Zweig in New York

HOW CFS USES MARKET CLOUT...

- 1) BUYS** credit-card debt that has been charged off by banks and other issuers. To keep the pipeline full, CFS has exclusive or near-exclusive long-term deals with 15 of the top 25 bank card issuers.
- 2) SECURITIZES** the debt and sells investors the notes. Since 1995, CFS, the first firm to pool bad consumer loans, has sold \$840 million worth, which it uses to buy more debt.
- 3) RETAINS** accounts and collects on debt. CFS uses sophisticated technologies to collect nearly three times what it pays for charge-offs. To squeeze out more profits, CFS will soon create a new company to make loans to least risky debtors.

DATA: BUSINESS WEEK

... TO TURN DEBT INTO GOLD



WAS HENRY KRAVIS OUTFOXED IN RUSSIA?

KKR claims it deserves a payout in Tatarstan. The government says "no deal"

In the U.S., they're Masters of the Universe. In Russia, they could be just another piece of roadkill. Three years ago, Kohlberg Kravis Roberts & Co. struck a deal with truckmaker Kamaz on the steppes of Tatarstan in central Russia. KKR agreed to raise money to pull the newly privatized company out of a deep financial ditch. In exchange, KKR got an option to buy a big stake in Kamaz. Since 1993, KKR partners logged hundreds of hours, spent millions out of pocket, lined up more than \$750 million in loans and refinancing, and dispatched consultants and lawyers to help Kamaz restructure.

With Russia's economy showing signs of recovery and its stock market surging, Kamaz may be on the brink of a turnaround. But Kamaz' management changed in June, and KKR's big payoff—control of a 16.5% stake currently worth \$50 million—may be snatched away. The government of Tatarstan, an autonomous republic within Russia, has taken control of Kamaz, and all bets are off as to whether KKR will receive its promised equity. Ravil Muratov, who is both Tatarstan's Deputy Prime Minister and Kamaz' new chairman, claims that KKR was required to raise equity capital, not bank loans. KKR declined public comment.

TOO OPTIMISTIC. Muratov contends that KKR took advantage of Kamaz when it was desperate. "I said to KKR: 'Can you show me where in your experience in Europe and America you can find idiots in a government who will give you something for nothing,'" he recalls. Unless the leveraged buyout firm immediately raises \$300 million in new equity, Muratov says, "KKR is not going to get hold of those shares."

Upon receiving Muratov's ultimatum,

KKR executives immediately hopped on a plane to Moscow to meet with him. The chairman refused to budge. KKR clearly will fight to protect its stake. And no wonder. KKR partners are among the world's savviest dealmakers, and they negotiated terms on a high-risk deal that could give them a huge potential payoff with only a \$50,000 up-front investment. If Kamaz gets back on track—and if KKR ever collects its equity—it will have paid a song to make a \$34 million profit on its stake.

Still, sources familiar with the deal note that Kamaz hasn't paid KKR a promised \$10 million a year in management fees since 1993. It's clear that KKR considers Kamaz' about-face a violation of Russian and international law. "This is a major international incident. They are thumbing their nose at the entire Western financial Establishment," says a key source.

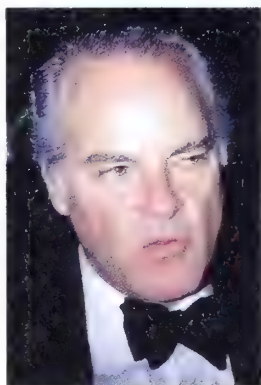
For its part, KKR may have misjudged the difficulty of turning around a Soviet-style industrial behemoth. And it may have been overly optimistic for Kravis and partners to expect to squeeze American-style fees out of a destitute truck factory. What is certain, though, is that the LBO firm underestimated the power of Tatarstan, one of Russia's richest and most fiercely independent regions.

Tatarstan may well get away with its move against KKR even though the firm has a strong claim to the equity. A lawyer who represented Kamaz in drafting the agreement says it clearly specified that bank loans would satisfy KKR's fund-raising obligations. The agreement permits KKR to seek arbitration outside Russia to settle the dispute. But an arbitrator's decision would have to be enforced by the Russian government. And Moscow may not want to pick a fight

with Tatarstan, one of the few Russian regions not in debt to the federal treasury. "KKR is probably sorry they've heard of Kamaz," says a Western banker who watched the drama unfold.

At least KKR has only the firm's—not their investors'—money at stake. Still, KKR invested large amounts of management time, including the personal involvement of the firm's two founders, Henry R. Kravis and George R. Roberts. Partner Michael T. Tokarz, KKR's point man on the project, averages an hour a day on Kamaz and is a frequent visitor to the factory. Time is a valuable commodity at a firm where just 11 partners manage a portfolio of 21 companies with combined revenues of \$47 billion.

The KKR dispute may scare away potential foreign investment in Russia. For instance, it could affect Tatneft, a big oil company based in Tatarstan that is poised to become the first privatized Russian company to



HANDS ON
KKR's Kravis was personally involved in helping Kamaz

A Doomed Deal

1993 KKR buys a 1% stake in Kamaz

1994 KKR is offered an option for 16.5% of Kamaz at 90 cents a share in exchange for finding \$300 million in financing. Under a vesting arrangement, KKR could exercise the option any time after 1998.

1995 KKR tops the \$300 million target with a series of bank loans and refinancings. Its right to exercise the option begins vesting.

JANUARY 1997 Tatarstan government

t a full American depository receipt
ting on the New York Stock Ex-
ange. The Tatarstan government
pes to issue Eurobonds by the end of
97.

In hindsight, KKR's investment may
pear rash for a firm without interna-
tional experience. But in 1993, Russia's
vestment potential seemed limitless.
dustries were being privatized with
e stroke of a pen, Western aid was
uring in, and Boris Yeltsin's govern-
ent was wooing foreign investors.
id Kamaz' management was eager
help. When it opened in 1975, Ka-
z was the world's largest truck fac-
y with 117,000 employees. In 1990,
e company was privatized and the
tarstan government retained an 8.3%
ike.

But even after privatization, the com-
ny's problems were massive. Its
icks were outmoded and its market
ied up. Kamaz even served as the

municipal government of Naberezhnye
Chelny and had to provide services for a
city of 500,000. Then, in 1993, a fire de-
stroyed the engine plant where Kamaz
and Cummins Engine Corp. had a joint
venture. Desperate Kamaz managers
called American Re-Insurance Corp.,
then owned by KKR, to assess the dam-
age. AmRe suggested calling KKR.



ment. Soon after, KKR agreed to the
complex arrangement under which it
could acquire Kamaz stock.

KKR quickly lined up a \$100 million
loan from the European Bank for
Reconstruction & Development and
\$150 million from Vneshtorgbank, a
Russian bank. It also secured refinanc-
ing of more than \$500 million in bank
debt, saving Kamaz mil-
lions in interest payments.
With help from consul-
tants—recruited by KKR
but paid for by Kamaz—the truck company made
considerable progress,
shedding most of its social
responsibilities and step-
ping up production of a
popular 3.5-horsepower
micro-car called the Oka.

But Kamaz slid deeper
into debt. In June, Kamaz'
board agreed to give



NEAR A TURNAROUND?

Assembling engines (left) and
trucks at Kamaz, a Soviet-style
industrial behemoth

Tatarstan a 43% stake in Kamaz in ex-
change for loan guarantees and restruc-
turing Kamaz' bank debts. KKR sup-
ported the transaction. The board also
ousted longtime Chairman Nikolai I.
Bekh, who had wooed KKR, and replaced
him with Muratov, a leading power in
the autocratic regime of Tatarstan's
Prime Minister Shaimiev. The Shaimiev
government had grown impatient with
Kamaz' slow progress under Bekh and
felt he had let KKR take advantage of
the company.

WHITE KNIGHT? Today, things are look-
ing up. Kamaz, which plans to spin off
its Oka division, has watched its stock
soar 175% this year. "Kamaz is at a
turning point," says Igor S. Antonov,
deputy chairman of Oneximbank, a ma-
jor Russian bank considering a loan to
the company.

Muratov depicts Tatarstan as a white
knight that is helping Kamaz much as
the U.S. government bailed out Chrysler
Corp. He pledges to pursue the restruc-
turing plan recommended by KKR, while
shoring up the truckmaker with tax
breaks, subsidies, and loan guarantees.
But just as KKR underestimated the dif-
ficulties of rescuing Kamaz, Tatarstan
may not realize the damage it could
cause itself by reneging on the KKR deal.
"It will piss off a hell of a lot of people,"
says a key source. If KKR gets run off
the road, Tatarstan and Kamaz could be
the real victims.

*By Carol Matlack in Moscow, with
Patricia Kranz in Naberezhnye Chelny
and Leah Nathans Spiro in New York*

ces deal to increase its stake in
from 8.3% to more than 40%.

1997 Tatarstan takes 43% stake in
Tatarstan's Deputy Premier
is the chairman of Kamaz.

1997 Tatarstan orders KKR to
p with \$300 million in new equity
for Kamaz or forfeit its stock
With Kamaz now trading at more
\$30 a share, KKR's potential
now worth \$50 million. KKR
Kamaz owes it more than \$30
in investment banking fees.

Soon after, when a delegation of Ka-
maz managers showed up at their Man-
hattan offices, Kravis and his colleagues
listened politely and sent them away.
"We told them: 'You don't qualify for
investments like we make,'" says a
source who attended the meeting. Twice
more Kamaz persisted, before offering
KKR an option to acquire shares in the
company in exchange for fund-raising
and management assistance.

Bolstered by expensive legal advice—
and the possibility of a huge payoff—
KKR took the plunge. "Henry and
George didn't put up any real money.
And if it did work, there would be enor-
mous upside," says one U.S. banker. In
1993, KKR paid \$50,000 for a 1% stake in
Kamaz and signed a consulting agree-

DEFENSE DEALS ARE FAR FROM OVER

Smaller contractors are linking up like crazy—and many are undervalued

The big defense contractors may all have paired off, but defense linkups continue apace. Instead of the melding of behemoths such as Lockheed and Martin Marietta, the action is now in smaller, high-technology concerns catering to the federal government. These information-technology services companies provide the Pentagon and other federal agencies with everything from knitting together old and new computers and software to averting year-2000 computer snafus. But unlike their high-technology brethren that cater to the broad business market, these firms are often overlooked and undervalued in the stock market.

AGGRESSIVE ADVICE. This new round of defense deals is being fueled by relatively low prices for target companies and changes in federal procurement policies. Jon B. Kutler, president of Quarterdeck Investment Partners Inc., which specializes in defense and aerospace investment banking, explains that "since the investment community made billions of dollars from the consolidation among prime contractors, they're actively looking for the next wave."

Defense info-tech services companies

Consolidation Plays

P-E RATIO* PRICE**

LIKELY BUYERS

COMPUTER DATA SYSTEMS	13.2	28%
COMPUTER SCIENCES	23.5	78%
TRACOR	16.9	26%

LIKELY TARGETS

BTG	13.8	14
CACI INTERNATIONAL	15.2	14%
NICHOLS RESEARCH	22.8	22%

*Based on 1997 earnings

** July 29

BY MASON WOOD WALKER,
BLOOMBERG FINANCIAL MARKETS



billions of dollars... among prime contractors, they're actively looking for the next wave'

KUTLER OF QUARTERDECK INVESTMENT PARTNERS

are dirt cheap compared with their peers in the commercial sector. Because of their lower margins and growth prospects, these companies have price-earnings ratios of roughly 20 (table)—about a third of the current price-earnings ratios at commercial information-technology service providers such as Keane Inc. or Computer Horizons Corp.

Changes in federal procurement policy will intensify the merger trend. Washington is consolidating small contracts into larger ones, which only bigger bidders can handle. The government is also placing more emphasis on experience and track record rather than the lowest bid, a shift that gives incumbents a leg up. So it can be easier to win a contract through a merger than a bid.

Sales of \$1 billion may be the mini-

mum needed now that titans such as Lockheed Martin and Litton Industries are horning in on the service market, says Peter A. Bracken, president of Computer Data Systems (CDSI). The \$400 million Rockville (Md.) company bought privately held Analytical Systems Engineering Corp. in June and is in the market to make more acquisitions. Companies with under \$500 million in sales "are beginning to see that they need the efficiencies of a large company to compete effectively against these giants," says Bracken.

IN THE PIPELINE. CDSI itself could be an acquisition target, says William Loomis, who follows information-technology services companies for Lazard Freres & Co. Mason Wood Walker Inc. CDSI's stock has taken a hit lately because of earnings disappointments. But Loomis believes

'Since the investment community made

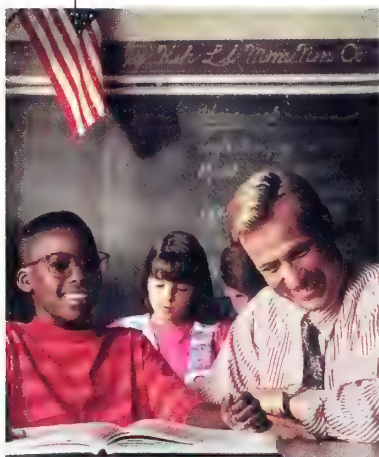
its strong management and expect the stock, now trading at 28%, to rise to 42 in the next 12 to 18 months. BTG has planned investments in a lottery contract in Argentina and other ventures start to pay off.

Another potential consolidation play is BTG Inc. Thomas M. Meagher, an analyst with Washington-based Fers Baker Watts, Inc., believes that several major government contracts that BTG has won in the past year will lead to a 25% earnings jump, to 81¢ per share, in fiscal year 1998, up from 50¢ per share in fiscal 1997. That, he says, could push the stock up to 17 from 14.

Defense consolidation, phase two, won't grab headlines the way the first go-round of billion-buck deals did. But the windfalls awaiting investors could be just as eye-catching.

By Stan Crock in Washington

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BY GENE G. MARCIAL

THE NEW WISDOM ON SALOMON

Two months ago, the takeover proslamented: "Salomon isn't for sale." Maybe then—but no longer.

In recent days, this global securities company "has been elevated to the top of the list of buyout targets," says a New York investment banker who claims to know about a "fresh expres-

sion of interest" by a U.S. commercial bank.

Indeed, shares of Salomon rose to 60% on July 30, up from 55 a few days before. That's close to Salomon's 52-week high of 61% in February. The stock has been a laggard all year, trailing the overall market and other brokerage stocks.

There is more than one set of eyes on Salomon: A Swiss bank is also looking, according to the investment strategist at one Wall Street bank. A representative of the Swiss bank has "informally communicated" its interest to Salomon executives, says this pro.

One shift in the Salomon equation: Warren Buffett, who controls 18.5%, is said to be more inclined now toward a sale. For one thing, Salomon seems to be turning the corner—on its way to improved profitability. Also, Salomon reported better-than-expected second-quarter results, prompting analysts to raise their 1997 and 1998 estimates.

"Currently, Salomon's price-to-book-value ratio is 1.30—one of the lowest in the industry," says Steven Eisman, an analyst at Oppenheimer. He has raised his 1997 earnings estimate from \$5.20 a share to \$6.30, although he's among those still wary about the predictability of Salomon's earnings. Much of Salomon's trading revenue is based on its proprietary trading—or trading for its own account. That makes the earnings stream, says Eisman, "more volatile" than those of its competitors.

Nonetheless, "Salomon's major problems are now behind it," notes one in-

vestment manager, who has started snapping up shares. If Salomon is able to maintain decent earnings, he adds, it could command a rich buyout price.

The investment banker who insists that he's aware of a U.S. bank's interest says Salomon's top brass may be swayed to sell with a purchase offer of three times the company's 1997 estimated book value of \$45 a share, or \$135 a share. But two times book, or \$90, appears to be the price that the U.S. bank may be willing to pay—in stock and cash. Salomon spokesman Robert Baker declined comment. Buffett couldn't be reached for comment.

MICRO-CAPS THAT LOOK LIKE WINNERS

How risky are the so-called micro-cap stocks? "Very," admits Audrey Jones of Morgan Grenfell Capital Management, who warns they may be hazardous to your portfolio. But for the savvy stock picker, she says, they're "where undiscovered shares with potentially huge returns are to be found."

To find winners, Jones sifts through 4,000 stocks with market capitalizations between \$10 million and \$300 million. Her Morgan Grenfell micro-cap fund has outscored the Russell 2000, an index of small-caps. Through July 28 this year, Jones's fund posted a return of 15.2%, vs. Russell's 12.7%.

Three micro-caps that Jones believes are way undervalued:

■ International Comfort Products (ICP), which designs and makes heating and cooling systems for residential and light commercial use.



JONES: Micro-caps are where you find the "huge returns"

Trading at 7% a share, the stock should double in a year, says Jones. The company makes private-label gear for Sears Roebuck and other distributors and has a 10% market share. Sales last year: \$642 million. ■ Mallon Resources (MLRC), an oil-and-gas producer in New Mexico. Trading at 7% a share, the stock is cheap at four times its cash flow of \$2 a share. Jones sees the stock hitting 15—"or more, if drilling escalates." She figures Mallon will earn

16¢ a share this year and \$1 next. ■ Optek Technology (OPTT), produces electronic sensor components for makers of autos, security systems, computers, communications gear, medical devices, and defense systems. Jones' target for the stock, now at 15, is 30. Optek may get a new contract from General Motors related to the car maker's new air bag. "If it gets the contract, it will add to Optek's earnings by 1999," says Jones. She expects \$1.2 a share in 1997 and \$1.45 in 1998.

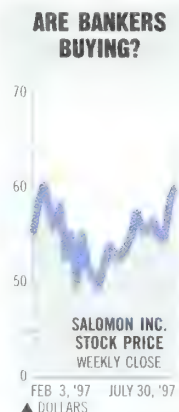
MYLAN LABS MAKES A RECOVERY

Although generic medicines remain the top choice among patients, the makers of these low-priced remedies have remained in the cellar: Investors have shied away because of price-cutting that seriously depressed earnings. But guess what? The price war seem to be over, and certain generic drug producers are sparking investors' interest.

"Signs of stability are emerging," says Ian Sanderson of Cowen & Co. His favorite: Mylan Laboratories (MYL), which has a line of 90 generic remedies. "We are upgrading Mylan to a buy rating, based on an improving earnings outlook in 1998-99," he says. "With its leading generic drug franchise, Mylan Labs is the top play in the expected near-term turnaround in the generic-drug market."

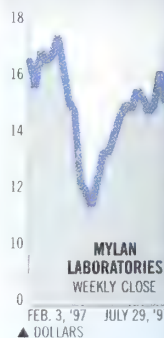
There's another reason for Mylan's appeal: a possible buyout offer from a foreign drugmaker wanting to get in on the rebound in the market for generics. As managed-care buyers embrace generics to balance their budgets, he says, "substitution rates will jump from 43%-45% of prescriptions in 1996 to 50%-55% by 2001."

Now at 17, Mylan is worth 35 in a buyout, say analysts. Top executives of a big distributor of pharmaceuticals agree Mylan is vulnerable. They say Mylan is getting edgy and may spin off one division to thwart a takeover. Mylan didn't return calls.



DATA: BLOOMBERG FINANCIAL MARKETS

THE MEDICINE IS WORKING



DATA: BLOOMBERG FINANCIAL MARKETS



OUT TO MAKE XEROX PRINT MORE MONEY

new president and ex-IBM
O Richard Thoman has a
ssion: Put the copier
unt back in the fast lane

Soft-spoken and low-key, G. Richard Thoman doesn't immediately come across as a battler. Indeed, his manner and attire suggest professor rather than pugilist. But when Xerox CEO Paul A. Allaire sought outsider to shake up the venerable copier company, his choice was the former IBM CFO. After spending a good deal of the past decade revamping Xerox, Allaire says the insular company isn't ready for an increasingly competitive, high-tech world, and he thinks Thoman has the stuff to fix that. "We're in a brawl with no rules," says Allaire.

On June 12, Allaire lured the 53-year-old Thoman away from Big Blue to be Xerox Corp.'s new president and heir apparent to the 58-year-old CEO, who plans to stay for only a couple more years. The seemingly easygoing executive sports a five-star résumé that includes stints as president of RJR Nabisco Inc. and head of international operations for American Express Co. As the protégé of IBM Chairman Louis V. Gerstner Jr., Thoman is known for his roll-up-the-sleeves style and knack for getting at what ails a business.

Only Xerox is hardly ailing. Its new crop of high-tech digital copiers are selling like hotcakes, and the overall document-management market is growing at 20% annually. Three years of aggressive restructuring have sent operating margins up nearly a third to 11.6%, while sales per employee have soared 44%.

THOMAN: *Itching for a bigger presence in home offices*

Yet Xerox still relies on old-fashioned and slow-selling analog copiers for more than half its revenue. That explains why, despite double-digit growth in new digital products and services, the company's sales rose just 4% in the first half of this year. For the year, Wall Street doesn't expect much more: Revenues are projected to grow 4% to 5%, to a little more than \$18 billion. Still, the stock has soared 47% this year, to 77¹/₂%, on rising profits, courtesy of the higher-margin new products and a growing service business.

DIGITAL PIONEERS. What Xerox needs now is more a field general than an architect. That's where Thoman comes in. He will execute a game plan that Allaire has sketched out but is still unfolding: the move away from stand-alone copiers toward a system of digitally connected copiers, printers, fax machines, and scanners. The only snag: Hewlett-Packard, IBM, Canon, and a host of others

have been leaving Xerox in the digital dust for years. Xerox insiders say that the rapid rise of the networked office surprised managers, and that prompted Allaire to pass over a couple of in-house candidates.

Thoman brings a persuasive track record. Before becoming IBM's top numbers guy, he oversaw the resurrection of IBM's Personal Computer Co., which he says was "in free fall." He turned the business into a winner by slashing payroll, reducing inventory, and revamping the internal information systems to closely monitor production and sales. Thoman, says Allaire, "has good operational, good strategic, and obviously good financial acumen."

At Xerox, Thoman will do some of the same things: namely, whack costs and sell off the last of the company's financial services units. Then he plans to

THE XEROX CHALLENGE

To pare and refocus the company, President Thoman will have to:

Negotiate a tricky transition in its core copier business from analog machines to new digital technology. Analog copiers will account for \$9.7 billion in sales, more than half of total revenues.

► Sell off its insurance businesses, which are a vestige of Xerox' ill-fated 1980s foray into financial services. Xerox has been auctioning off pieces, but three units have yet to be sold.

► Continue the cost-cutting and restructuring that have been the hallmark of Paul Allaire's seven-year reign as CEO. Although overhead has been sliced by 10%, the company believes it must do more.

► Respond to new competitors, such as Hewlett-Packard, that are chipping away at Xerox' franchise in the document-reproduction business. Xerox must broaden its distribution by signing more retailers.

DATA COMPANY REPORTS

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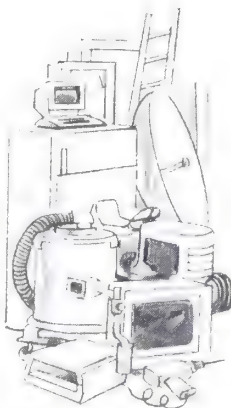
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target the small-business and home office arena, where Xerox is itching for a bigger presence. One way to do that is to increase the number of retail outlets, including superstores, that carry Xerox products from 3,000 today to 4,500 by the year 2000. He's also going to dramatically increase the number of products Xerox sells through retail outlets to include its full line of copiers, inkjet printers, and multifunction machines. Until now, retailers primarily sold personal copiers. All told, Thoman hopes to quadruple sales of personal copiers and multifunction machines through these channels by 2000. "The market opportunity," he says, "is more exciting than I thought when I came."

Then there's Xerox' digital future. The Document Centre multifunction copiers introduced in April are selling so fast the company has had to increase manufacturing capacity. (Analysts estimate Xerox has already blown by initial 2000 year estimates of 50,000 units.) Once Xerox gets customers hooked on the new machines, which are priced from \$8,000 to \$10,500, it can sell them more expensive, advanced digital copiers and networking setups. Xerox hopes this move will blunt the success of its rivals. "Xerox is feeling threatened by us," says HP's Carolyn M. Ticknor, who heads HP's laser-printer division.

AT YOUR SERVICE. But for all this competition, the real sweet spot is good old-fashioned service contracts for managing the flow and copying of documents for large corporations. For Xerox, this business has doubled over the past two years to \$1.3 billion, although the market is rife with well-heeled competitors that include IBM and Electronic Data Systems Corp.

Now Thoman plans to expand his business, which does everything from managing office-supply purchasing to providing Internet services such as designing electronic-commerce systems. One way is to offer a new Net service that will run electronic ordering and billing systems. Xerox will then manage the sorting, saving, and retrieval of the online documents. "Document services will ultimately be our lead offering for large customers," says Allaire. "It's a big part of our future."

Thoman isn't a techie. But at IBM, he proved to be a quick study who was more capable of managing change in the digital era than IBM's own engineering wizards. That, more than anything, may explain why Allaire placed Xerox' fate in the hands of this outsider.

*By Tim Smart in Stamford, Conn.
 with Peter Burrows in San Francisco*

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SCANDALS

MAN IN THE MIDDLE OF DONORGATE

Was Ted Sioeng funneling money or just doing business?

Ted Sioeng had arrived. On the evening of July 22, 1996, he sat proudly beside Bill Clinton in the glitzy ballroom of the Century Plaza Hotel in Los Angeles at a dinner that raised \$800,000 in campaign donations. For Sioeng—an Indonesian businessman who

environmental Affairs Committee probes into whether Beijing attempted to influence last year's elections, Sioeng could be a linchpin in the scandal. He and his daughter Jessica Elnitiarta have given about \$400,000 to politicians since 1995, the bulk of it to Democrats. And some of those donations allegedly coincided

MID-TO-LATE 1960s

While in his 20s, Ted Sioeng, the adopted son of an ethnic Chinese couple, develops a profitable foam rubber business in Indonesia.

EARLY-TO-MID 1970s

China begins opening up, and Sioeng, who speaks three Chinese dialects, begins selling used cigarette-making equipment to Yunnan Province tobacco companies. Later he will sell used medical, toy, and other manufacturing equipment acquired in the U.S. and Canada.

LATE 1970S TO EARLY 1980s

Sioeng moves to Hong Kong for easier access to the mainland. Yunnan Provincial government grants him a license to sell Hongtashans, a popular cigarette

HONGTASHAN CIGARETTES

brand, outside China. He makes them in Singapore and distributes them in Asia and eventually the U.S.

MID-1980s

Sioeng and wife, Sundari Elnitiarta, apply for visas through a U.S. immigration lottery. In 1987, Elnitiarta's visa is approved, and she moves with their five children to Los Angeles. Sioeng frequently visits but officially lives in Hong Kong and Singapore to run his empire, which now includes several joint ventures with Chinese companies.

EARLY 1990s Sioeng helps his eldest child, Jessica Elnitiarta, establish a real-estate



development company, Panda Estate Investments. Panda's holdings now include a Beverly Hills luxury condo building, two Hollywood motels, a medical center in Fullerton, and a Chinatown office building. It is also partial owner of Grand National Bank in Santa Ana, Calif. The family becomes a frequent contributor to Chinese-American politicians and organizations.

APRIL, 1995 Sioeng and Jessica each make \$50,000 contributions to help the campaign debt of California State Treasurer Fong, a rising Republican star who personally spent the funds. Fong has returned the money.

JULY, 1995 Fong arranges for Sioeng to meet in Washington with House Speaker Gingrich. A week later, Fong donates \$50,000



now-dubious National Policy Forum think tank, closely associated with former Republican National Committee Chairman

began life in an orphanage and whose limited English made small talk with Clinton difficult—what was a night to remember is now part of a nightmare he'd like to forget.

Sioeng (pronounced shong), 52, a multimillionaire who made a fortune selling used factory equipment in China and exporting Chinese cigarettes to the West, finds himself at the center of Donorgate. According to sources familiar with both Justice Dept. and Senate Gov-

with large wire transfers from the Bank of China to their U.S. bank accounts.

Is Ted Sioeng the key to Donorgate? Or is he simply a flamboyant entrepreneur doing business in America the way he does business in Asia—using his wealth to boost political connections. Through their lawyers, Mark J. MacDougall and Steven R. Ross of Washington, Sioeng and Elnitiarta deny that Beijing was behind any of their contributions or that they ever acted on China's behalf.

This much is known: Intercepted conversations indicate that top Chinese officials discussed ways to influence U.S. politicians and may even have mentioned people friendly to Beijing who might be enlisted in the effort. MacDougall says he wouldn't be surprised if Chinese diplomats raised Sioeng's name—he is also called Sioeng Wong—because he is pro-China.

Sioeng, who declined to be interviewed, is not a permanent U.S. resident—his passport is from Belize—his wife and children are. He has not been seen in the U.S. since winter 1995, is believed to be living in Hong Kong.

Sioeng's views on China are more emotional than political, say friends. He is not an ethnic Chinese but was raised in Indonesia by a Chinese couple. Ironically, he appears to be a free-market capitalist. Sioeng became wealthy in

What a Lo

a license to sell the popular Hong-Kong brand of cigarettes—called Red Panda Mountain in the U.S.—outside China. The wire transfers he receives from the Bank of China, according to a source familiar with the transactions, are largely dividends from his cigarette venture, a dollar-based business.

Despite his affection for China, Sioeng is crazy about the U.S. He is known to wear ties imprinted with the name of Liberty, and friends say he is so enamored of America that he decided to raise his five children in the U.S. His wife obtained a visa through the immigration lottery, and in 1987, the family moved to Los Angeles. Sioeng is behind to take care of business and made frequent extended visits.

His eldest child, Jessica Elnitiarta—uses her mother's maiden name—manages the family interests in California. She is the sole shareholder of Panda Investment Inc. Panda holdings include two Hollywood hotels and a 24-

Formerly pro-Taiwan, the paper today is pro-China, some readers say, because it runs releases issued by Beijing news agencies. But Jamie Lim, deputy general manager, says Sioeng isn't around enough to influence its content.

DEEP POCKET. Sioeng often donated money to Asian-American groups, and his generosity to Iowa Wesleyan College was recognized with an honorary doctorate. Inevitably, pols began to view Dr. Sioeng, as he sometimes calls himself, as a deep pocket, too. California State Treasurer Matt Fong, a Republican, was among the first to come calling. Fong, now running for a U.S. Senate seat, received \$100,000 from Sioeng and Elnitiarta in 1995. When reports suggested the money came from China, he returned it.

Others familiar with Sioeng's giving say they don't see China behind the donations. Fong aggressively solicited Sioeng after his 1994 treasurer's race, they say. And Fong concedes that he went to Sioeng's office "no more than

Republican National Committee subsidiary that raised questionable foreign money. Some Democrats have alleged that Elnitiarta's \$50,000 check, for example, was covered by a Bank of China wire transfer made the previous day. Lawyer MacDougall denies this. Elnitiarta gave the money, says a friend, because she was told the NPF would hold an event at her hotel. It never did.

Soon, Sioeng's largesse caught the eye of Democratic fund-raiser John Huang. He invited Sioeng and Elnitiarta to his maiden event as a DNC fund-raiser in February, 1996, and to the now infamous April, 1996, Buddhist Temple lunch with Vice-President Al Gore.

It was also Huang who invited Sioeng to the Century Plaza fund-raiser. A Democratic source says Huang's practice by this time was to solicit wealthy Asian Americans to buy entire tables so they could impress foreign guests with their White House connections. Elnitiarta gave \$250,000 altogether, and

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k, Calif., raising his
the Chinese com-
The paper has been
an; under Sioeng,
it is pro-China.

RY, 1996 In the
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ers William
e appears at a Chi-
v Year event at



GINGRICH

Washington's Hay
Adams Hotel. All four are
organized by Democratic
National Committee mon-
eyman John Huang who
approached Sioeng and
Jessica. Jessica donates
\$100,000 to the DNC.

APRIL, 1996 Sioeng and
Jessica both attend a con-



GORE'S TEMPLE SPEECH



INTERNA-
TIONAL
DAILY NEWS

controversial fund-raiser held at
a Southern California Bud-
dhist temple, featuring Vice-
President Gore as speaker. Some of the funds raised
came from Buddhist nuns
and monks, allegedly to
conceal their foreign source.

MAY, 1996 Sioeng and
numerous associates, some
from China, attend a glitzy
dinner at Washington's Sher-
aton-Carlton Hotel. Jessica
donates \$50,000 to the
DNC.

JULY, 1996 Sioeng, Jessica,
and dozens of guests attend
a dinner at the Century
Plaza Hotel in Century
City, Calif. Sioeng and
James Riady sit next to
President Clinton. Jessica
donates \$100,000 to the
DNC.

APRIL, 1997 News articles
name Sioeng and Jessica as
the focus of a Justice Dept.



SIOENG AND RIADY WITH
CLINTON IN L.A.

investigation into alleged
Chinese government influ-
ence-buying during the
1996 elections. The Senate
Governmental Affairs Com-
mittee, headed by Republi-
can Fred Thompson, probes
their ties to both
political parties. Sioeng
and Jessica both
deny hav-
ing done
anything
illegal.



THOMPSON

luxury condo in Beverly Hills. The
erties are worth some \$25 million
the condo alone produces nearly \$1
on in annual pretax profit, according
Sioeng's lawyers. This means Elni-
a, 31, easily could have made polit-
donations out of her own pocket.
amount of money they gave was
big deal to them," says a friend.
Sioeng's most visible asset is the *In-
ternational Daily News*, a Chinese-lan-
guage newspaper in Monterey Park.

10 times" seeking money. Sioeng has told
friends he gave Fong \$50,000 because
he was weary of his pleas. Fong even
helped him write the check because of
Sioeng's difficulty with English.

Fong also arranged for Sioeng to
meet House Speaker Newt Gingrich in
1995, though Sioeng didn't know who
Gingrich was. A week later, a Gingrich
aide asked Elnitiarta to donate \$50,000
to the National Policy Forum (NPF).
Critics say the GOP think tank was a

this enabled Sioeng to invite associates
from mainland China to three DNC
events. The DNC has kept Elnitiarta's
donations, which are legal because she's
a permanent U.S. resident. If nothing
else, she and her father have learned
that a few hundred thousand dollars
can buy plenty of political connections—
and a whole lot of grief—in America.

By Paula Dwyer in Washington, with
Larry Armstrong in Los Angeles and
Dave Lindorff in Hong Kong



MOTOR SPORTS

SPEED SELLS

Auto racing is suddenly sizzling—as a sport and a business

Imagine you're pressed against a fence overlooking the back straight of a modern superspeedway. From a mile away, a wall of sound is building. Suddenly, the roar of 700-horsepower Ford and GM engines swells to a crescendo as 40 stock cars streak past you with a velocity that nearly rips your face off.

What did you see? Well, it was mostly a blur, but it looked as if the big Kellogg's Corn Flakes box was ahead of the orange Tide container. And the car done up like a yellow Kodak film package was nosing past the one festooned with McDonald's golden arches.

Naked commercialism that turns cars into 180-mph billboards—and attracts more sponsor dollars than any other sport. A soaring TV audience that makes media moguls go limp at the prospect of cheap, popular programming. Sold-out grandstands crammed with fans who think nothing of spending a weekend—and hundreds of bucks apiece—at a

speedway. And poised to cash in on it all: aggressive racing conglomerates that are using millions raised from the equity markets to build new tracks and snap up existing ones. No wonder the racing biz is glowing hotter than an exhaust pipe after a 500-mile run.

How hot is that? Ask one of the new breed of racing entrepreneurs, such as O. Bruton Smith, William C. France Jr., or Roger Penske. Convinced that mega-speedways capable of holding upwards of 150,000 fans are the wave of the future, the trio has triggered a consolidation binge that's turning American racing on its ear.

STAR DRIVERS. The reverberations extend all the way to Europe. This fall, Bernard Ecclestone—the czar of the enormously popular Formula One racing format—plans to float shares in a new company that he hopes will extend Grand Prix racing's reach to the far corners of Asia. The prize, if Ecclestone

manages to pull it off, will be upwards of \$2 billion.

If you're wondering why rights market Formula One could command such a sum, look at it from Ecclestone's perspective. A typical F-1 race—featuring ultrasophisticated \$4 million rockets and star drivers that tap into Europe's swelling nationalism—watched by a television audience of 100 million. Only World Cup soccer and Summer Olympics command a larger following.

The growing demand for sports programming in Europe makes F-1 especially attractive to broadcasters. Contracts such as Germany's DF1 and France's Canal Plus see Grand Prix racing as a lure for subscribers and are willing to pay handsomely for TV rights. As television contracts soar, so do profits. This year, F-1 projects pretax earnings of \$139 million on revenues of \$1 billion. Ecclestone reckons that if only

MECHANIZED MAYHEM

NASCAR has built a fanatical following—a fact not lost on the networks and cable operators

ing is poised to break out of its Southeastern and Midwestern base to rich new media markets, U.S. promoters have embarked on a massive construction binge. The financing source: rising television revenues and cash from stock sales.

In the process, the speedway kings are transforming American racing. Once the grimy pastime of fly-by-night promoters and scruffy amateurs, auto racing is mutating into something vastly more profitable—a button-down world of Wall Street financiers, megabuck sponsors, and corporate hospitality suites. True, the pin-striped set may never be totally comfortable rubbing shoulders with hard-charging racers. But with a business that offers operating margins of 30%, who cares?

CHARM SCHOOL. And the good old boys of summer who used to bang fenders on Tobacco Road? Bubba's had his teeth capped and gone to charm school. The new hero-driver model: stock-car champion Jeff Gordon, 26, who looks like a surfer and seems stamped from the same safe-and-sanitary mold as golfing star Tiger Woods.

It wasn't always this way, of course. In 1995, Smith, who started out flogging cars and real estate in Charlotte, N.C., had a revelation. High-tech startups were raising millions with initial public offerings. Why not racetracks? So he took Speedway Motorsports Inc. public, raising \$75 million.

The IPO had an electric effect on the industry. The Daytona Beach (Fla.) France family, which controls the National Association of Stock Car Auto

Racing (NASCAR)—the sport's top rule-making body—felt the buzz. In short order, the clan issued new low-priced shares in its International Speedway Corp. (ISC), creating the first real market in ISC's once sleepy stock.

Penske, whose \$6 billion empire includes Detroit Diesel Corp. and truck-leasing and auto dealerships, wasn't about to be left behind. Last year, he took Penske Motorsports Inc. public, raising \$82.7 million.

Although Smith was among the first to sense the dimensions of the boom, the credit for setting the sport's dizzying pace goes to NASCAR. By staging super-competitive sedan races that fans could identify with, it built a huge following of stock-car fanatics. Enter television programmers on the prowl for product. As major networks and cable operators such as ESPN, Fox Broadcasting, The Nashville Network, Turner Broadcasting, and the new Speedvision channel televise ever more races, the audience keeps on growing. Last year, 112 million households tuned in to NASCAR events, while attendance at its premier Winston Cup races hit 5.6 million.

Those numbers stoke sponsor interest, since advertisers view the massive exposure they get from racing as a cheap buy. Says Joyce Julius, head of Joyce Julius Associates Inc., a Dearborn (Mich.) sports-marketing firm: "We measured total ad images from the Winston Cup series last year and discovered there was nearly \$900 million worth of sponsor exposure." The upshot, says Julius: "If, say, Valvoline oil writes a \$6 million check to sponsor a race team, they're getting back nearly \$30 million in advertising."

According to Jim Andrews, vice-president of *IEG Sponsorship Report*, a Chicago-based newsletter, NASCAR's corporate support is expected to grow to \$441 million this year, up from \$405 million in '96. Total motor-sports sponsorship

could hit \$920 million, up from \$845 million last year. That tally is expected to grow at a 5%-to-10% clip, showcasing such brands as the Cartoon Network, Budweiser, and DuPont paint. By comparison, golf sponsorship was \$555 million in 1996, and other major stadium sports racked up a combined \$365 million.

And race fans don't just turn out in



of current viewers fork over, say, to get a digital broadcast featuring interactive views of a race, revenues double. "Very few businesses can st profits for seven years out," tone boasts. "I can."

opens first popularized motor and, truth be told, still look down American variants as the boorish imitations of country bumpkins. Eccle sneers that U.S. oval racing is stage-managed that it's more akin to show business—like wrestling—than road racing.

haps. But in candid moments, racers do credit U.S. entrepreneurs with the financial flair that undercuts the sport's current burst of attention. Sensing that oval-track rac-

ONS FOR BERNIE?

ula One czar Ecclestone is a public offering e fall that could raise rds of \$2 billion



droves. They're intensely loyal to the brands they associate with the sport. According to marketing studies, 70% of the devotees of NASCAR and Indycar racing—which features fenderless, cigar-shaped racers that zoom around tracks such as Indianapolis—purchase some of the featured products. That's nearly double the brand loyalty for pro football, baseball, and basketball.

Smith wasn't the only promoter who had these figures burned into his consciousness. But he was one of the most aggressive when it came to cashing in on the phenomenon. That meant a big expansion of seating at his speedways, which include circuits in Charlotte, Atlanta, Bristol, Tenn., Sonoma, Calif., and a new \$140 million, 185,000-capacity oval in Fort Worth. At Bristol alone, Smith took seats from 77,000 to 116,000. Seating at his tracks will rise to 525,000 this year, up from 289,000 in 1996. In July, he announced plans to raise \$125



million via a private bond placement. The cash will retire debt—and pay for more seats.

New seats are crucial to a speedway's balance sheet. Typically, a promoter pockets \$4 million or more for TV rights for a big event. (Teams and drivers are paid by sponsors and organizers out of a prize pool.) Parking, souvenir sales, and hospitality-suite rentals generate a tidy profit. But the big jolt to the bottom line comes from filling the grandstands. "It costs \$400 to put up a new seat," says H. B. "Tom" Thomson III, an analyst at Wheat First

THREE MEN AND THE MARKET

Penske and France took the hint when Smith (below) went to Wall Street in 1995

Butcher Singer Securities in Richmond, Va. "At each race, you can get \$800 per seat from a spectator, plus an average of \$10 in concession sales. In just four races, you've earned back your investment."

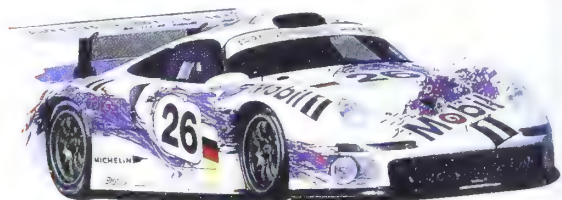
EARNINGS CLIMB. This rapid return for speedway syndicates operating margins of 27% to 38%. Says E. Breck Wheeler, a racing analyst at J. C. Bradford & Son in Nashville: "These companies should be able to see 20% earnings growth over the next three years, no problem." Motor sports pros agree. "Tracks today run like a business," notes Chrysler Corp. Executive Vice-President Francois Castaing, former chief engineer of Renault's Formula One team. Under the speedway kings, "they're a machine to make money."

That's certainly the way things go from where Smith is sitting. A recent June night finds him ensconced in a glass-enclosed suite atop his new

SCREAM MACHINES: WHICH IS WHICH



FORMULA ONE High-tech 220-mph open-wheel projectiles from Renault, Peugeot, Ferrari, Mercedes, Honda, and Ford



G.T. RACING Production-based sports cars—such as Porsches, Mercedes, and McLarens—that run on road circuits

or Speedway, hobnobbing with brities and sizing up a crowd of 100 below. That's a lot fewer than 185,000 who braved monsoon-like and monster traffic jams to attend his April NASCAR opener. But it's a showing for the Indy Racing League, a struggling series that must do with unknown drivers and low-budget race cars.

While Smith's guests help themselves beer and brisket, race-goers are being fed up for the feature event.

Elvis impersonators parade single file into the infield to ops from the crowd. A prize artist twirls precariously in a helicopter. Fireworks fill the sky. "Pretty subdued for me," Smith says dryly. "Not blowing much stuff tonight." No kidding. At Smith's Charlotte Motor Speedway, he once recreated the invasion of Grenada, complete with cannon, paratroopers, and attack helicopters.

Smith makes no apologies for predictions that push the envelope from the merely tacky to the truly tasteless. When it comes to racing in on America's fascination with speed, he believes there's no business like show business. "A race is just a race," Smith says from his Charlotte office, waving at stock cars rumbling below. "I want a spectacle."

Smith's gung-ho style makes NASCAR seer Bill France cringe. Nonetheless, France's International Speedway Corp. seems eager to copy his rival's "We'll get 'em and they will come" approach. ISC is adding more seats at its tracks in Daytona, Darlington, S.C., and Talladega, Ala. And it just acquired control of the road course at Watkins Glen, N.Y. In July, ISC bought Phoenix International Raceway for \$46 million. Later, France teamed with Penske to gain control of South Florida's new Homestead track for \$23.6 million. Next targets: building ovals near Phoenix, Kansas City, and Sacramento where Smith can get there.

Midway between Smith's high-roller style and France's more measured ap-

proach is Roger Penske. A meticulous executive who raced sports cars before he traded his helmet for a briefcase, Penske has moved swiftly since Penske Motorsports went public last March.

In May, he bested Smith for the right to buy a controlling interest in North Carolina Motor Speedway in Rockingham, and, in late June, he rubbed salt in the wound with the triumphant opening of his \$100 million California Speedway, located between Los Angeles and Palm

CLKs. Evans may go public in 1998. "What's needed now," he says, "and what Ecclestone, Penske, France, and Smith are trying to do, is to professionalize this sport."

Ecclestone couldn't agree more. "People talk to me about a chain of theme restaurants," he says. "No time for it. Merchandising? Don't get a penny—too busy. It's time for racers like me to give way to the businessmen in suits who can do all these things."

What might the suits do to give F-1 the interstellar dimension Ecclestone dreams of? For starters, IPO cash could market the F-1 brand more assertively. The model is NASCAR, which sells nearly \$770 million a year worth of racing merchandise. Ecclestone also could recoup some of the \$88 million he sank into mobile-TV production and filming facilities, which he ships to races aboard two 747 cargo jets. Above all, he wants to expand Grand Prix racing's foothold in Asia. Ecclestone is eyeing \$200 million government-subsidized circuits planned for Malaysia and South Korea, plus an existing facility in Zhuhai, China. F-1 has staged a race in Suzuka, Japan, for several years.

NEW KID IN TOWN. Heady stuff, this race biz. And those fat profit margins certainly make speed syndicates look like winners. But

investors who dream of a quick trophy need to proceed with caution. Although Fidelity Investments and other small-cap funds have taken positions in the U.S. companies, the shares aren't keeping pace with the Dow. "We're a new phenomenon to Wall Street," shrugs France. "It's going to take time for those folks to understand our business." Says Scott Barry of Raymond James & Associates Inc. in St. Petersburg: "The stocks are not inexpensive. The underlying economics are fantastic, but the market seems to view speedway stocks as long-term growth plays."

Beyond that, potential saturation of the airwaves with race programming and the rush to build tracks in the few remaining markets mean that at some

SPEED, INC.

Speedway stocks hold plenty of zoom for racing moguls.

But for the most part, shareholders are still idling.

STOCK	IPO	CURRENT*
INTERNATIONAL SPEEDWAY CORP. (ISCA)	20	20%
Controls six tracks, including Daytona and an 11% share of Penske Motorsports		
PENSKE MOTORSPORTS INC. (SPWY)	24	32%
Owens or controls five tracks, including the new California Speedway in Fontana		
SPEEDWAY MOTORSPORTS INC. (TRK)	18**	21 1/8%
Owens five tracks, including the new Texas Motor Speedway outside of Fort Worth		
G.P. ASSN. OF LONG BEACH (GPLB)	10	13%
Owens two tracks and stages the annual Long Beach IndyCar race		

*As of July 29, 1997 **Split 2 for 1 in 1996

DATA: J.C. BRADFORD

Springs. The track seems like a cross between Daytona and Disneyland: There are plush facilities, racegoers are called "guests," and uniformed host workers circulate to make sure fans are having a quality experience.

Racing IPOs don't just attract the circle-track crowd. Road-racing aficionados also want in on the action. Seattle money manager Andrew L. Evans, a wealthy chum of Microsoft Corp. CEO William H. Gates III, recently bought the top U.S. sports-car racing organization and snapped up circuits in Sebring, Fla., and Mosport, Ont. Evans aims to build the audience for road racing by bringing top European racers to the U.S., and with them \$1 million McLarens, Porsche GT1s, and Mercedes



STOCK CARS T-Birds and Monte Carlos in fender-banging action. NASCAR rules the top races



INDYCAR U.S.-style open-wheel racers, heavier and less exotic than Formula One. Rival leagues: CART and IRL

point, the speedway kings may have to downshift. But don't tell that to Smith, France, and Penske, who are busy planning grander circuits, more corporate suites—and more cash flow. "The new financial guys coming into the sport are smart," says Smith, "and they're helping racing grow. But you've still got to have guys like me in the trenches."

Smith still daydreams of putting a

dome over Bristol—he hasn't quite worked out the bugs in the exhaust fans yet—and of building a New Jersey track that would loom as a golden detour on the road to Atlantic City casinos. And just to get under the skin of those oh-so-proper Europeans, he's thinking of bringing stock-car iron to a new oval developers plan in Germany.

"See, we get these giant Russian

Antonov-124 airlifters, the biggest jets in the world," Smith says dreamily. "and then we just load our cars on and..." Surely, the man is joking. Is he?

By Lee Walczak in Charlotte, N.C. with Stephanie Anderson Forest in Fort Worth, Tex., Bill Vlasic in Denver, Ronald Grover in Los Angeles, Heidi Dawley in London

A GAMBLE AS BIG AS TEXAS

Out in the parched prairie north of Fort Worth—deep in the heart of Nowhere—O. Bruton Smith has rolled the dice big-time. He has gambled \$140 million that he'll be able to lure enough fans to turn Texas Motor Speedway (TMS) into the capital of his auto-racing empire.

On nearly 1,000 acres acquired from developer Ross Perot Jr., Smith has erected 150,061 grandstand seats and 205 skyboxes around a 1½-mile oval. And there are plans for 76 trackside condos—for supersound sleepers.

"We thought Texas would be big when we built it," says Smith. "It turned out to be colossal." A little 10-gallon bluster? Maybe not. In April, some 185,000 fans showed up for a NASCAR race. According to a University of North Texas study, TMS is expected to generate 3,400 jobs and pump \$160 million a year into the local economy. (Fort Worth's Chamber of Commerce says a weekend of NASCAR racing brought in almost \$36 million.)

Maybe that's why Smith was able to cut a deal with the Fort Worth Sports Authority that should save him some \$90 million in taxes over 30 years. In its first year, figures Wheat First Butcher Singer analyst H. B. "Tom" Thomson III, TMS will rack up net income of \$4.8 million on revenues of \$37 million for owner Speedway Motorsports Inc.

Not too shabby. Still, it's nowhere near the profit Smith needs to recoup his investment. The most crucial task: snaring more top-tier events. One of NASCAR's coveted

Winston Cup races generates \$8 million to \$10 million for a track. TMS is now making do with one, plus secondary events.

Competition from other new speedways makes the chances of an additional Winston Cup race problematic. Indeed, Smith secured his April race only by acquiring a smaller track and moving the event to TMS. "Texas [could be] extremely profitable with two Winston Cup

\$850 per race weekend. And TMS sells "preferred seat licenses" that guarantee the same seat for 30 years as long as you continue to buy season tickets. Cost: \$750 to \$2,000 a season. Some 40% of the 36,000 licenses have been sold thus far.

Like all modern tracks, TMS leverages its asphalt to the hilt. It plans to earn extra money by renting time to car clubs, truck-show promoters, used-car sellathons, and fantasy driving schools. In June, country and rock-music festivals pulled in estimated revenues of \$300,000 to \$500,000 apiece.

SOOTHING ROAR? TMS's condos remain a curiosity for nonracing fans. But somehow, Smith, who pioneered the concept at his Charlotte and Atlanta speedways, manages to sell them. TMS is building 76 apartments high above the track—at \$275,000 to \$575,000 apiece. All have been purchased. "I just sold two to a lady from Taiwan who manufactures silk flowers," says super-salesman Smith with a grin. "I have no idea what she wants them for."

No doubt about it, the man can sell. But industry veterans caution that unless he can corral more big-time races, Smith could wind up with the kind of hangover Willie Nelson sings about. "Our concept is 'If you build it, they will come,'" says Speedway Motorsports executive Thomas M. Sadler. As the racing world looks on, Smith is about to find out if that happens only in the movies.

By Stephanie Anderson Forest in Fort Worth, with Lee Walczak in Charlotte, N.C.



ALL THIS AND CONDOS, TOO

To recoup its huge investment, Texas Motor Speedway must snare more top-tier events

dates," says Speedway Motorsports President H. A. "Humpy" Wheeler. "With one, it's essentially a break-even or small-profit situation. These new tracks eat money. We need more racing to feed the monster."

Still, those corporate suites should help. Smith charges companies \$65,000 to \$100,000 a season. In Texas, 120 of the 205 boxes are leased to outfits such as Electronic Data Systems, Coca-Cola, and IBM. The track also rents exhibition space in an adjacent Corporate Village. There's infield parking for 1,300 motor homes and campers at \$350 to

INTERNET DRESS DIRECTORY

3m.com

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amd.com

etna.com

merican Institute
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ia.org

ican Century
americancentury.com

ican Power Conversion
apcc.com

ur Andersen
ArthurAndersen.com

rsen Consulting
ac.com

Computer
st.com

tt.com

Insurance & Investment
axa.com

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www.chryslercorp.com/

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Digital PC
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Diners Club International
www.dinersclub.com

E*TRADE
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Exide Electronics
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Hammermill
www.hammermillpaper.com

Hewlett-Packard
www.hp.com

Hilton Hotels & Resorts
www.hilton.com

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www.ml.com/

Microsoft
www.microsoft.com/

NCR
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Norfolk Southern
www.nscorp.com

Nortel
www.nortel.com

Northrop Grumman
www.northgrum.com

Northwest Airlines
www.nwa.com

Novell
www.novell.com

Oracle Corporation
www.oracle.com

Palm Computing
A division of U.S. Robotics
www.usr.com/palm

PeopleSoft
www.peoplesoft.com

PLATINUM technologies
www.platinum.com

The Principal Financial Group
www.principal.com

Praxair
www.praxair.com

QUALCOMM
www.qualcomm.com/cdma/

Roberts Express, Inc.
www.roberts.com

RPS, Inc.
www.shiprps.com

SAP
www.sap.com

SAS Institute
www.sas.com/

Savin
www.sales@savin.com

Charles Schwab
www.schwab.com

Siemens
www.siemens.com

SkyTel
www.skytel.com

Southern Company
www.southernco.com

Sprint
www.sprint.com

Sun Microsystems
www.sun.com

Sybase
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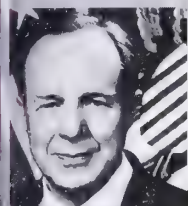
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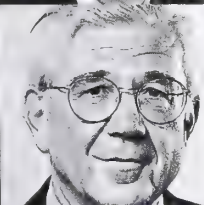
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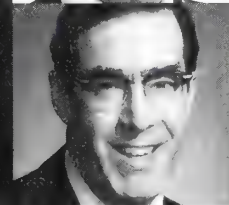
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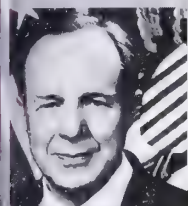
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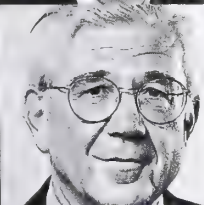
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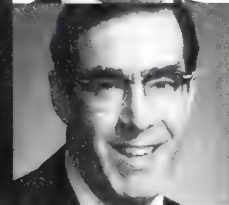
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DRUG TESTING

SHOULD THE FDA LOWER THE THRESHOLD?

For some drugs, says Cephalon, testing standards are too high

For Dr. Patricia K. Coyle, the testimony was wrenching. Speaker after speaker described how paralyzing Lou Gehrig's disease had relentlessly robbed them or their loved ones of the ability to walk, feed themselves, or even hold a pencil. Tearfully, they pleaded in May with Coyle and five other neurologists on a Food & Drug Administration advisory committee to clear the way for approval of a new drug, Myotrophin—a genetically engineered, insulinlike growth factor that might slow the disease's advance.

But for Coyle and the other panel members, the facts were less persuasive. The drug's manufacturer, biotech startup Cephalon Inc., simply hadn't

proved its case. "There was no way you could review that data and say unequivocally that this agent worked," says Coyle, a professor at the State University of New York at Stony Brook. The vote against the drug was 6-3, with only nonphysicians dissenting. By Aug. 11, the FDA is expected to decide whether to approve the drug—with the panel's thumbs-down weighing heavily.

Whether the panel acted correctly is a matter of heated dispute. Myotrophin is a case study in how well-meaning regulators and companies with little capital can err when dealing with diseases for which there is little or no treatment. Startups such as Cephalon may be aiming too low in designing studies that

fail to provide enough evidence to justify approval for such drugs. However, critics charge that regulators set high a bar for drugs targeted at poorly understood diseases by applying the same tough standards used for routine medications, such as preferring studies showing the same results.

Lou Gehrig's sufferers are caught in the middle. "I want the opportunity to see if it would work for me," says Siegel M. Oppenheimer, a 30-year-old former day-care center director from North Hope, Pa., who was diagnosed with Gehrig's disease in 1996. "I'm not an idiot. If it doesn't work, I'm not going to keep taking it."

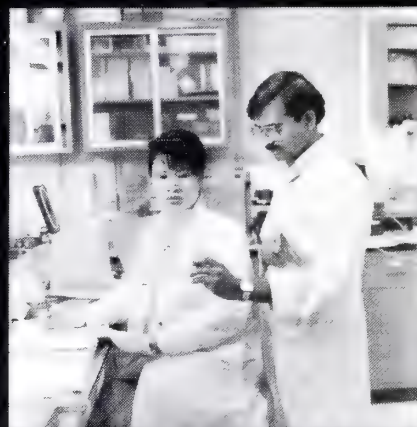
Precedent may be on her side. The FDA has broken with tradition to approve some AIDS medicines on the basis of one trial. They've gone on to become life savers. And the agency eventually approved Warner-Lambert's Cogentin for Alzheimer's sufferers, even though three studies showed the drug offered only marginal, if any, improvement from some of the fatal disease's symptoms.

Five years ago, Myotrophin's future seemed bright. Researchers at Cephalon



NEW HOPE? Afflicted with Lou Gehrig's disease, Oppenheimer wants to try an unapproved drug

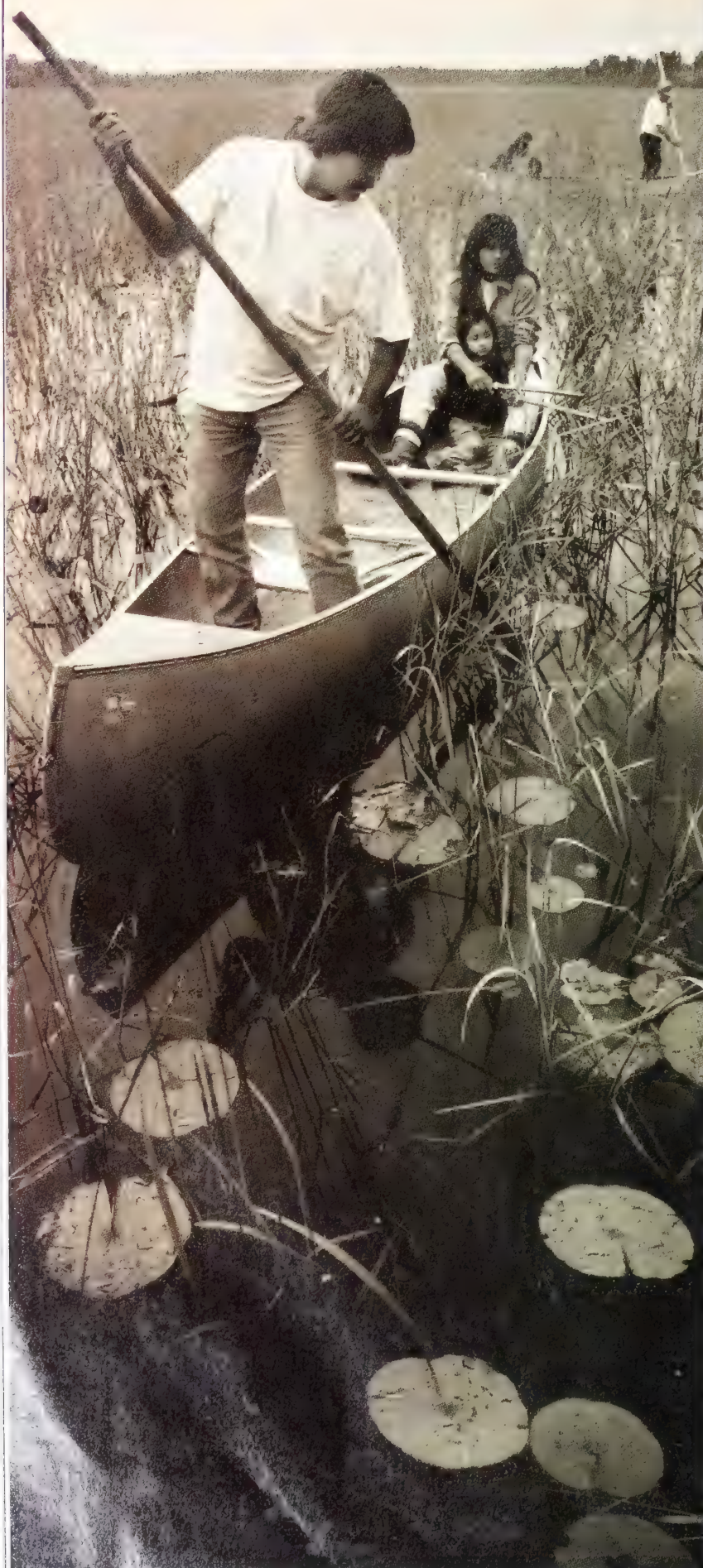
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According to legend, a little child had a dream about the best way to harvest and prepare wild rice. That should be knocked from the stalks with blessed sticks, then parched in the sun and danced on to remove the husks. The people did this and they made it through the winter with enough to eat. "Manomin" was the word the child dreamed, and that became the word for rice. "Menominee" is the name of the tribe, and it means "Keepers of the Rice." These words and traditions came from the dream of a child. Which is just one reason the Menominee have always made it a point to talk to their children. And to listen.



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d in West Chester, Pa., began re-
ch in 1992 to see if the drug, which
notes nerve growth, could stymie a
use that afflicts up to 30,000 Amer-
.. Scientifically dubbed amyotrophic
al sclerosis (ALS), its cause is most-
known—though its consequences
clear: irreversible wasting of mus-
usually leading to death from res-
ory failure in less than five years.
After initial tests determined the
was safe, Cephalon had to prove
it worked. But that was trickier.
After researchers launched their
es—on 266 patients in North Amer-
early 1993, and on 183 Europeans
that year—they found that any
ovement was modest. Some had
er muscle tone or more ease in
lowing, for instance, and a measur-
slowing of some patients' decline
reported. Still, in mid-1995, based
e North American results, Cepha-
lone claimed "highly statistically signifi-
effects" with patients showing 26%
deterioration" than those on a
bo. Chief Executive and company
der Frank Baldino Jr. heralded
d news for a lot of people."

on came the bad news. In October,
Cephalon reported that in the Eu-
an trial, Myotrophin fell
of treatment

More disturbing,
European death
was notably higher
Myotrophin than on
placebo—14.5% vs.

"I wouldn't even
lude that it is a mar-
drug," says Dr. Sid
an, head of the FDA
sory committee. "I sus-
that it is ineffective."

5 MAKE A DEAL. Why
difference between the
studies? Cephalon execs
say the European pa-
s were sicker than Amer-
counterparts. But the FDA
d not overlook the Euro-
results, particularly since

agency generally wants to see two
ies before it will approve a new
g. With one study showing some ef-
iveness, however, the regulators
ted to keep the drug available as
s continued. So in mid-1996, the ad-
ry committee ruled that a limited
ber of patients outside the formal
ies could receive the drug until a fi-
decision is made. However, the com-
ee insisted that Cephalon provide
ncing new data.

y last February, though, Cephalon
ded it had done enough. The com-

pany and its partner, Chiron
Corp., filed with the FDA for
approval to sell Myotrophin.
Baldino told regulators that
Cephalon had spent \$180 mil-
lion on research and would
have a tough time justifying
further investment. "It's al-
most impossible for us to idly
throw \$20 million or \$30 mil-
lion at another study," Baldino
told regulators.

Instead, Cephalon offered a
deal. If regulators let it start
selling the drug—some anal-
ysts say Myotrophin could
fetch up to \$10,000 a year per
patient—Cephalon would do
further research. It proposed
combining Myotrophin with
the only approved ALS medi-
cine, Rilutek, so that doctors
could see the drug's useful-
ness in the field. Rilutek, a
Rhône-Poulenc Rorer drug ap-
proved in December, 1995, extends life
for ALS sufferers by an average of three
months but offers no improvement in
physical functions. Backers theorized a
combination of the two drugs could do
both modestly.

But the advisory



**"[We can't]
idly throw
\$20 million
or \$30 million
at another
study."**

FRANK BALDINO
Cephalon Inc.

cient data and says the pa-
tients testified without com-
pany encouragement.

Now comes the FDA. The
agency could overrule its ad-
visers and approve the drug,
a rare move. It could grant
conditional approval, reserv-
ing the right to order with-
drawal if future studies prove
disappointing. Or it could say
no—a decision likely to meet
with opposition from congres-
sional members pressing for
approval. Senator Orrin G.
Hatch (R-Utah) wrote to the
agency: "There is an occasion
here to provide patients with
a drug they need at no risk
to public health, and I hope
the FDA will be able to seize
that opportunity."

Doctors who treat ALS also
urged a speedy O.K. at the
hearings. Even the slightest
benefit is better than nothing, they said,
and the typical two-study demand may
be too high a hurdle. "We're not talking
false hope. We're talking modest hope,"
says California Pacific Medical Center
neurologist Dr. Deborah F. Gelinas.

HARD LESSONS. Whatever the outcome,
the case offers drugmakers hard lessons.

Lesson one: Large trials,
though costly, may
pay off. "I'm quite
sure it would have
been statistically sig-
nificant if they had
two times as many
patients," says Johns
Hopkins University
neurologist Dr. Ralph
W. Kunkel. Lesson two:
Heed advisory com-
tee requests for more
data, even if you believe
you've done enough.

For regulators, the case
raises troubling questions.
Should standards be lower
for deadly diseases that lack
treatments? Even now, the
Senate is weighing a bill that

makes it clear the FDA has the authority
to approve drugs based on a single trial.
And when should compassion override
rules? Says University of Pennsylvania
bioethicist Arthur Caplan: "It is morally
relevant not only what the evidence is,
but what the plight is of the people who
might be helped." With an admittedly
weak treatment and a horrific ailment
before it, the FDA now must decide what
makes for the smartest medicine.

By Joseph Weber in Philadelphia

Rx

THE CASE FOR MYOTROPHIN...

Myotrophin offers some relief for
sufferers of Lou Gehrig's disease.
Some patients report better mus-
cle tone and an improved ability to
swallow. Physicians have reported
a measurable slowing in the rate
of deterioration. The medicine
might be even more effective if
combined with another recently
approved drug that extends life for
the disease's sufferers.

...AND AGAINST

Contradictory studies—one
showing effectiveness, the other
not—means the case for FDA
approval has not been made. The
drug's sponsor should resolve the
uncertainty once and for all with
a third study. Otherwise, the
FDA would be clearing a
drug—and a pricey one at
that—whose modest success
in an early test could well
have been a fluke.

panel had a narrow
charge—to determine whether the
drug showed "substantial" effectiveness.
Without two convincing trials, it had-
n't. What's more, Cephalon's approach
irked committee members. "I thought
their presentation was a bit on the slop-
py side," says Coyle. One committee
member charges that "Rather than do-
ing the science...the company wanted
to call in the most pitiful cases and use
the emotional pressure of people with a
very bad disease." Baldino insists the
company already had presented suffi-

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EDITED BY NEIL GROSS

HI-TECH DESIGNS: FOUND PLASTIC MODELS

THE MID-1980S, WHIZZES manufacturing melded computer-aided design (CAD) with plastic model-making equipment. The result, called stereolithography, lets product designers create finished physical models from computer screens. Now, engineers at Sandia National Laboratories have gone a step further, actually manufacturing metal parts directly from CAD.

Following specifications from off-the-shelf design software, a laser burns a pit in a metal substrate to create a



LASER BURN: Metal magic

molten pool measuring about thirty-thousandths of an inch in diameter (photo). Metallic powder is then sprayed at the focus of the beam while a stage moves the substrate back and forth. As the material melts and cools, "the

finished object materializes before your eyes, layer by layer," says Clinton L. Atwood, Sandia's team leader for rapid prototyping. The process eliminates several manufacturing steps, he says, and the result is "a dense metal part with excellent metallurgical properties."

Initially, industry may use the technology to create metal tools or templates for plastic injection molding. But ultimately, factories could employ the same process to produce auto parts or to repair worn tips on turbine blades in aircraft engines. Sandia is completing a technology-transfer agreement with manufacturing giants Eastman Kodak Co., 3M, and others. □

LENCING SNORERS WITH RADIO WAVES

RED OF LISTENING TO YOUR PARTNER snore? Somnus Medical Technologies in Menlo Park, Calif., has received Food & Drug Administration clearance for a technique that remodels the palates of snorers, moving the excess tissue that obstructs breathing and causes all the clatter.

The technique, called "somnoplasty," is an alternative to surgery. After applying a local anesthetic, a doctor wires the patient's

body with electrodes, inserts a needle into the palate's soft tissue, and pipes in radio-waves. These agitate ions in the tissue, resulting in heat that kills the excess cells.

During the half-hour outpatient procedure, the patient feels a slight warmth and, for a few days afterward, a scratchy throat. But in a few weeks time, the body flushes out dead cells and the palate retracts to permit easy breathing. Somnus says the treatment will cost about \$2,500 in the U.S. It has enlisted Medtronic Inc. of Minneapolis to help export the procedure to Europe and Asia. *Stephen Baker*

ENZYME IT CAN KNOCK OUT NERVE GAS

ACTIVATING THE 200,000 of chemical weapons currently stored at munitions sites worldwide is a daunting task. But researchers at the University of Pittsburgh have a promising technique that uses a long-lasting, easily storable enzyme stabilized in polyurethane foam.

The method was developed by Alan Russell, director of

the University of Pittsburgh's chemical and petroleum engineering department. It makes use of an enzyme called phosphotriesterase that was discovered by scientists at Texas A&M University. Described by Russell as "one of the most efficient enzyme catalysts ever discovered for any reaction," the enzyme breaks oxygen-to-phosphorous bonds in dangerous chemicals, leaving harmless byproducts that can be safely burned. A drop of the enzyme will cause one ton of nerve gas to biodegrade within a year, he says. Unfortunately, though, it's ac-

tive only in a liquid environment, while most chemical weapons are not soluble in water.

To solve this problem, Russell stabilizes the enzyme in foam, which is then suffused with the noxious chemicals. In its sponge form, the enzyme can be stored for months at room temperature, he says. The German Defense Ministry is considering testing the enzyme in the decontamination of real chemical weapons. And the U.S. Army may use the technology in protective suits. *Johanna Knapschaefer*

MINDING THE KIDS—ON THE NET

PARENTS WHO WORRY about their kids in day care may soon find reassurance at the click of a mouse. WorldWide Access in Chicago is testing a system called KidCam that lets parents with Internet access observe their child's day-care room on their PCs—and even enjoy a scheduled teleconference.

For security reasons, parents at participating day-care centers are asked to register and use membership numbers and passwords. Once that's set up, they log on to the center's Web site remotely and navigate to their child's room. If the parent's PC has a video camera, a feature called Kid Chat permits videoconferencing.

Kathleen Vrona, vice-president for marketing and sales and a co-founder of WorldWide Access, says the system has received good reviews in trial centers such as Rainbow Child Care & Learning Center in Naperville, Ill. In addition, as many companies that offer on-site day care have discovered, parents who are resting easy about their children's well-being tend to be more productive at work, Vrona says. *Elizabeth Veomett*



ON VIDEO: KidCam kids

EDITED BY AMY DUNKIN

GOING ONCE. GOING TWICE. CYBERSOLD!

Marty Duplissey knows his way around auctions. He attends maybe six a year, bidding on forklifts, trucks, and other heavy equipment. But more often these days, the Longview (Tex.) software developer, whose family is also in the furniture and cattle businesses, practices his auction skills on the Internet. Duplissey regularly visits several Web sites, where he figures he outbids competitors for computer gear and software half the time. When he prevails, he gets the goods at 30% to 50% off the retail price. "It's so convenient," he says. "I can check the status of a bid and up it from anywhere at anytime."

Cyberauctions are breaking out all over the Net. The Internet Auction List (IAL) contains 1,500 links, mostly to the Web pages of traditional auction houses, directories, and publications. But IAL includes links to more than 100 online auctions, too. "What draws people is the lure of the bargains," says Jerry Kaplan, chief executive of Onsale, a publicly held online-auction company. Visitors to the IAL site can also gain access to BidFind, a search engine that lets them type in "Pentium" or "Tamagotchi" to find places where these items are put up for bids. For now, however, the same few auction-company names always turn up.

ONLINE

As one might expect, a wide variety of computer and consumer-electronics products are selling at Web auctions. But plenty of general merchandise is also up for grabs. EBay's AuctionWeb lists Barbie dolls, baseball cards, and musical instruments among its fare. Winebid.com offers fine vintages. The Internet Shopping Network's First Auction site, a subsidiary of the Home Shopping Network, offer golf clubs, Krups espresso machines, and—you've seen 'em on the tube—Ginsu knives.

Onsale recently started offering Omaha Steaks. Other online auctions are dedicated to stamp collectors and those seeking timeshares, airline seats, or books.

Unlike in-person auctions, the Internet variety may last from a day to a week or more, and the formats vary. So-called Dutch auctions, such as those at Klik-Klok Online Dutch Auction, reverse the process. Klik-

Klok offers clocks, garden tools, and jewelry. With the clock ticking, prices drop incrementally every few seconds, until a registered bidder clicks the mouse to snatch the product.

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low ear-
there's a
end, the

person who made
the first bid wins.

► Sign on at least
20 minutes before
the close of the
auction to make
sure your last bids
were registered.

Finding an Auction on the Web

SITE / WEB ADDRESS

eBAY'S AUCTIONWEB
trig.ebay.com/aw

FIRST AUCTION
www.firstauction.com

HAGGLE ONLINE
www.haggle.com

INTERNET AUCTION LIST
www.usaweb.com

**KLIK-KLOK ONLINE
DUTCH AUCTION**
www.klik-klok.com

ONSALE
www.onsale.com

TRAVELBIDS
www.travelbids.com

WINEBID.COM
www.winebid.com

COMMENTS

Private sellers hawk a variety of merchandise.
You can do a keyword search to locate items.

From the folks who bring you the Home Shopping
Network: Bid on PCs, cameras, and golf clubs.

Offers computer products and miscellaneous
items; has an online computer museum.

Contains links to nearly 1,500 auction-company
Web sites, publications, and directories.

Features a "Dutch" or reverse auction wherein
prices decline until a buyer makes a bid. Sells
gold and diamond jewelry.

One of the largest online auctions for PC gear
and accessories—plus Omaha Steaks.

A reverse auction for airplane deals, cruises, and
resorts, in which travel agents bid for business.

A chance to bid on mature premium vintages,
from Opus One to Chateau Mouton Rothschild.

DATA BUSINESS WEEK

whether you want to buy
from a service such as On-
sale, which owns most of the
merchandise it sells, or from
private individuals who put
up their wares on such sites
as AuctionWeb's (for a small
fee, plus a percentage of the
sale price) or Haggle Online's
(currently free). You might
get a good deal from a pri-
vate seller, but he or she may
also be less reliable. In any
case, you may want to E-mail
or call the auction company
or seller to clarify questions
about what's included in an
offer. To some degree, the
Net is self-policed, so an un-
reliable seller may be identi-
fied by other members of the
service. AuctionWeb actually
rates some sellers based on
users' comments.

Wherever you buy, deter-
mine in advance exactly how
much you are willing to pay.

► If you don't win
on your first try,
check the next
auction list.
Chances are a
similar product
will show up and
you may get it
even cheaper.

Don't forget to factor in the
shipping costs. Be prepared
to stick to your guns. "You
can pay too much real fast,"
says Duplissey. Just as you
might poke around the card
tables in Vegas before
putting down your own mon-
ey, it's a good idea to watch a
few auctions before bidding
to determine strategy.

The first time you place a
bid at Onsale, you enter the
amount and the quantity of
the item, your billing and
shipping addresses, and cred-
it-card information (which is
encrypted). You may then up
the ante by an incremental
preset amount. You can track
how you're doing by clicking
on the item's catalog page,
where the highest bidders
are posted. You must con-
stantly reload the page to see
if you remain on top. Cust-
omers who are outbid may
also be notified by E-mail. Of
course, as an auction nears
its conclusion, the action can
get fast and furious. So if you
want something badly enough
you should stay logged on.
When customers make bids,
they can also leave comments
for their competitors, such as
"I'll go up to \$1,000. Don't
make me do it." But unlike
an in-person auction, you

can't eyeball your com-
petitors to assess when
they're likely to throw in
the towel.

If there's a tie, those
who bid on more than one
of the same item win out.
The next tiebreaker is the
time the initial bid was
placed, so getting in early,
even with a low bid, may
help put you in the win-
ner's circle.

SIGHT UNSEEN? Some ser-
vices, such as AuctionWeb,
allow buyers to indicate
privately the maximum
amount they are willing to
pay for something, so bids
are made by the company
on their behalf when other
customers bid up the
price. You would not be
charged the maximum
price if a lower bid could
capture the prize.

While bargains on new
merchandise can surely be
found, many of the products
Onsale and First Auction are
hawking represent manufac-
turer's overstock or refurb-
ished computer products and
other items. Goods may be
out of season or old models.
(Of course there's nothing
wrong with this stuff if it fits
your needs.) Most items come
with warranties, and the com-
panies will make good pro-
vided a product reaches you
dead on arrival. But remem-
ber, you are agreeing to buy
an object sight unseen, un-
less there's a photo, and all
sales are final. Except in rare
instances, you'll be stuck with
the thing if you emerge the
highest bidder. If there is a
dispute with the seller, it may
help to have paid with a
credit card because you can
sometimes cancel the charge.
A credit card is the required
form of payment on most ser-
vices, anyway.

One other thing to keep in
mind: Online auctions can be
seductive. You can readily get
caught up in the thrill of the
chase and vie for products you
don't want or need. Indeed,
it's all too easy to find the
funds in your bank account
rapidly going, going, (gulp)
gone.

Edward C. Baig

REVERSE MORTGAGES SHIFT INTO HIGH GEAR

For a generation of seniors whose biggest asset is their home equity, reverse

mortgages should have been the perfect product. By borrowing against the value of their houses, owners can receive a monthly check from a mortgage lender to supplement their income. Later, after they've moved into nursing homes or died, their heirs can pay off the debt by selling the property. But up till now, reverse mortgages have been a bust. Their high fees plus the reluctance of many older people to take on additional debt, have tended to limit the market to the most destitute or those looking to stave off foreclosure.

Now, mortgage giant Fannie Mae wants to make the reverse mortgage a staple of senior life, which ensures that if you're over 62, you can count on seeing more solicitations in your mailbox. But its latest variation on the theme—dubbed Home Keeper for Home Purchase—still suffers from the high fee structure that limits the appeal of existing products. "For people who find themselves against the wall with no other source of funding, this is a plus," says Gary Schatsky, a New York lawyer and financial planner. "For everyone else, this should still probably be their last option."

Fannie Mae, the government-chartered company that buys and securitizes nearly 20% of all the nation's mortgages, clearly doesn't see Home Keeper as a last resort product. It is aimed at

seniors who might like to move closer to their children—or to warmer climes—and buy a higher-priced house without taking on new mortgage payments. That group might include house-rich and cash-poor seniors—or people who don't want to cash out other investments to buy a house because they believe they can earn a higher return elsewhere. For now, Home Keeper loans are available only for detached houses, but Fannie Mae plans to extend the program to condominiums.

But Fannie Mae isn't stopping there. In the next few years, it expects to roll out other reverse mortgages that use a homeowner's equity to do everything from providing long-term disability insurance to paying for home health care. The reverse mortgage "will become a major finan-

cingly mobile group of seniors. Unlike the traditional reverse mortgages, which can give older homeowners who have paid off their mortgages monthly income by borrowing against their equity, Fannie's newest offering is designed for individuals who want to buy a new house without making mortgage payments. You may also be able to pull out some equity from your first house to use for other purposes. The key is combining a large downpayment with the loan to make up the purchase price (table).

Up till now, any buyer

to use a reverse mortgage the initial purchase of a house, however, Fannie Mae says will substantially reduce transaction costs.

"LAST OPTION." Despite savings, financial experts think that the terms on the Home Keeper product aren't attractive. Sahadi estimates participating banks are charging roughly one percentage point over conventional mortgages, or about 9%. In addition to a 2% origination fee, the borrowers must pay "insurance fee," which protects the bank against the risk that you will live so

that your loan balance will exceed your equity. Both fees are assessed against the purchase price of the house, not the sale price of the house, not the sale price of the house.

Terms of these loans can vary dramatically among lenders, says experts suggest shopping around. Brody Belling, a reverse mortgage expert at the American Association of Retired Persons, notes that some lenders can borrow again for \$150,000 house value vary by as much as \$30,000, depending on which bank is considering making the loan. The loan amount is based on the equity in the first house as well as the borrower's age and other factors.

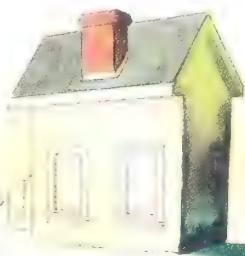
If you would like more information, call Fannie Mae at 800-664-3. For \$25, the profit National Center for Home Equity Conversion (7373 147th St., Apple Valley, Minn. 55121) sells a 340-page consumer guide that will explain in detail how reverse mortgages work. Once you understand all the nuances, you can decide for yourself whether Home Keeper is a clever or simply a loan that's overpriced.

Dean F.

How Fannie Mae's New Plan Works

The example assumes a 76-year-old woman wants to sell a house she owns free and clear—and buy a new one without having to make mortgage payments.

- ▶ She sells the old house for \$75,000.
- ▶ She applies to Fannie Mae for a "reverse mortgage" loan to buy a \$115,000 house.
- ▶ Based on her \$75,000 in equity, plus other factors such as age, Fannie Mae gives her a \$60,000 loan at a rate about a point higher than a conventional mortgage.
- ▶ She then uses the \$60,000 loan plus \$55,000 from the sale of her old house to pay for the new house and live there without making monthly mortgage payments.
- ▶ She keeps \$20,000 from the \$75,000 sale proceeds.
- ▶ When she moves or dies, the house is sold, and the loan balance gets paid off from the proceeds.



DATA: FANNIE MAE, EQUITY WEEK

cial tool that could be linked with any type of senior financial need," says Robert Sahadi, Fannie Mae's vice-president for housing initiatives.

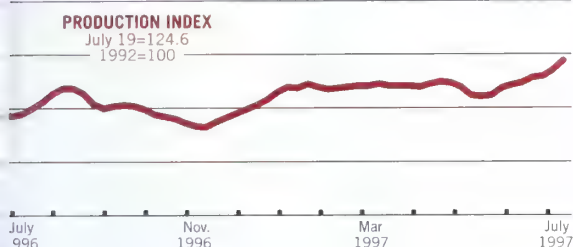
With its latest option, which will be available through 400 mortgage lenders in 45 states, Fannie Mae hopes to tap into an increas-

wanting to take out a reverse mortgage on a new house had to incur two sets of transaction costs, one set to buy the property and another set to convert the standard note into a reverse mortgage. That meant thousands of dollars in additional closing costs and other fees. By enabling buyers

Business Week Index

PRODUCTION INDEX

Change from last week: 0.7%
Change from last year: 3.7%



The production index increased again during the week ended July 19. Before the four-week moving average, the index jumped to 126, from 124.6 in the previous week. Seasonally adjusted output of autos and trucks rose strongly, and unseasonably warm weather across parts of the nation led to a surge in electric-power output as well. Production at crude-oil refineries, coal, steel mills and rail-freight traffic declined for the week.

Source: U.S. Dept. of Commerce, July 1997 by The McGraw-Hill Companies

LEADING INDICATORS

	LATEST WEEK	WEEK AGO	YEARLY % CHG
STOCK PRICES (7/25) S&P 500	938.79	915.30	47.6
GOVERNMENT BOND YIELD, Aaa (7/25)	7.09%	7.15%	-7.0
INDUSTRIAL MATERIALS PRICES (7/25)	107.3	105.6	0.5
NEW BUSINESS FAILURES (7/18)	NA	NA	NA
REAL ESTATE LOANS (7/16) billions	NA	NA	NA
MONEY SUPPLY, M2 (7/14) billions	\$3,926.1	\$3,936.8r	4.8
UNEMPLOYMENT CLAIMS, UNEMPLOYMENT (7/19) thous.	299	341r	-6.6

Sources: Standard & Poor's, Moody's, *Journal of Commerce* (index: 1990=100), Federal Reserve, Labor Dept.

INTEREST RATES

	LATEST WEEK	WEEK AGO	YEAR AGO
MORTGAGE RATES (7/29)	5.52%	5.44%	5.33%
COMMERCIAL PAPER (7/30) 3-month	5.57	5.54	5.54
SAVING DEPOSITS (7/30) 3-month	5.58	5.57	5.55
FIXED RATE MORTGAGE (7/25) 30-year	7.60	7.65	8.40
ADJUSTABLE RATE MORTGAGE (7/25) one-year	5.75	5.81	6.10
LIBOR (7/25)	8.50	8.50	8.25

Sources: Federal Reserve, HSH Associates, Bloomberg Financial Markets

1=Seasonally adjusted data in the production indicators are seasonally adjusted in computing the BW index (chart); other components (estimated and not listed) include machinery and defense equipment. 1=Western Wood Products Assn. 2=Southern Forest Products Assn. 3=Free market value NA=Not available r=revised NM=Not meaningful

THE WEEK AHEAD

CONSTRUCTION SPENDING

Monday, Aug. 4, 10 a.m. EDT ▶ Spending on construction projects likely rebounded by a 0.8% in June, according to the new forecast of economists surveyed by International, one of The McGraw-Hill Companies. Public-works and nonresidential construction likely led the increase. Spending dropped 1.8% in May, but construction activity had risen steadily before

stock market and better orders offset a gain in unemployment claims and drop in building permits. The leading indicators give no sign of trouble for the economy going into 1998.

THE BEIGE BOOK

Wednesday, Aug. 6, 2 p.m. EDT ▶ The Federal Reserve's survey of regional economies will round up reports on business activity within its 12 districts. During his semiannual talk to Congress, Fed Chairman Alan Greenspan discussed tightness in the labor markets and its inflationary consequences. Consequently, market participants will be most interested in the Beige Book's reports on labor-market conditions and ris-

ing wages. The Beige Book is prepared in advance of the Fed's next policy meeting, scheduled for Aug. 19.

INSTALLMENT CREDIT

Thursday, Aug. 7, 3 p.m. EDT ▶ The MMS report forecasts that consumers added \$4.5 billion in new credit in June. That's suggested by a gain in retail sales and vehicle purchases. In May, installment debt rose by only \$3 billion, down from the \$7.2 billion average in the previous four months. Revolving credit, which includes credit cards, was up only \$0.7 billion in May. Consumer-debt growth has slowed sharply in 1997, as banks tighten lending standards and households pay down existing debts.

PRODUCTION INDICATORS

	LATEST WEEK	WEEK AGO	YEARLY % CHG
STEEL (7/26) thous. of net tons	1,983	2,046#	1.3
AUTOS (7/26) units	106,490	103,790r#	-14.4
TRUCKS (7/26) units	117,509	82,806r#	9.8
ELECTRIC POWER (7/26) millions of kilowatt-hrs.	74,851	77,484#	2.8
CRUDE-OIL REFINING (7/26) thous. of bbl./day	14,827	14,919#	5.2
COAL (7/19) thous. of net tons	20,710#	19,420	0.9
LUMBER (7/19) millions of ft.	506.4#	480.2	7.5
RAIL FREIGHT (7/19) billions of ton-miles	25.9#	24.9	-0.8

Sources: American Iron & Steel Institute, *Ward's Automotive Reports*, Edison Electric Institute, American Petroleum Institute, Energy Dept., WWPAl, SFPAl, Association of American Railroads

PRICES

	LATEST WEEK	WEEK AGO	YEARLY % CHG
GOLD (7/30) \$/troy oz.	327.550	324.900	-15.0
STEEL SCRAP (7/29) #1 heavy, \$/ton	143.50	134.50	7.5
COPPER (7/25) ¢/lb.	113.9	112.1	18.0
ALUMINUM (7/25) ¢/lb.	77.5	75.0	10.7
COTTON (7/26) strict low middling 1-1/16 in., ¢/lb.	72.37	71.67	-6.7
OIL (7/29) \$/bbl.	19.56	18.76	-8.7
CRB FOODSTUFFS (7/29) 1967=100	240.70	238.67	-11.8
CRB RAW INDUSTRIALS (7/29) 1967=100	339.66	332.72	0.0

Sources: London Wednesday final setting, Chicago market, *Metals Week*, Memphis market, NYMEX, Commodity Research Bureau

FOREIGN EXCHANGE

	LATEST WEEK	WEEK AGO	YEAR AGO
JAPANESE YEN (7/30)	118.33	115.76	106.77
GERMAN MARK (7/30)	1.84	1.82	1.47
BRITISH POUND (7/30)	1.63	1.68	1.56
FRENCH FRANC (7/30)	6.19	6.14	5.00
ITALIAN LIRA (7/30)	1787.5	1773.0	1519.2
CANADIAN DOLLAR (7/30)	1.38	1.38	1.37
MEXICAN PESO (7/30)*	7.780	7.834	7.576
TRADE-WEIGHTED DOLLAR INDEX (7/30)	106.5	105.3	96.6

Sources: Major New York banks. Currencies expressed in units per U.S. dollar, except for British pound in dollars. Trade-weighted dollar via J.P. Morgan

LEADING INDICATORS

Monday, Aug. 5, 10 a.m. EDT ▶ The Conference Board's index of leading indicators increased 0.1% in June. That would be a 0.3% advance in May. A rising

This Week, Online

Business Week presents frequent live conferences and chats on America Online—your opportunity to ask questions about features from the magazine.

BusinessWeek **ONLINE**

Sunday

With the stock market red-hot, is it time to sell—and take your profits—or hang on for further gains? Ask two experts: Charles Carlson of *DRIP Investor, No-Load Stock Insider*, and *Dow Theory Forecasts* newsletters and BW's own Jeffrey M. Laderman. **Aug. 3**
9 p.m. EDT in the Odeon

Monday

Entrepreneurs everywhere can find hope—and help—from the Young Entrepreneurs Organization, whose members have all hit \$1 million in sales before 40. Talk to YEO founder Verne Harnish in one of our weekly Enterprise chats. **Aug. 4**
8 p.m. EDT in the BW Enterprise Chat Room

Transcripts of all conferences are available for downloading from the BW Online area on AOL soon after each event



For a free trial diskette including 50 free hours on AOL, call 1-800-641-4848 and mention Business Week.

Index to Companies

This index gives the starting page for a story or feature with a significant reference to a company. Most subsidiaries are indexed under their own names. Companies listed only in tables are not included.

A

Access Beyond 42
Adidas 38
Alcoa (AA) 42
AlliedSignal (ALD) 64
Amdahl (AMH) 42
American Airlines (AMR) 69
American Century 42
American Express (AXP) 69, 81
American Re 76
Amoco (AN) 64
AMR (AMR) 28
Analytical Systems Engineering 78
Anheuser-Busch (BUD) 38, 86
Apple Computer (AAPL) 64, 104
AT&T (T) 33, 64, 104
AuctionWeb 98
Avis Rent A Car System 61
Avon (AVP) 64

B

Bain 64
Bear Stearns (BSC) 61
Bell Atlantic (BEL) 33
Benetton 4
Bharat Petroleum 46
Boeing (BA) 42
Bradford (J.C.) 86
British Airways (BAB) 42
British Telecommunications (BTY) 42
BTG 78

C

California Speedway 86
Campbell Soup (CPB) 64, 104
Canal Plus 86
Canon (CANNY) 16, 81
Carnier (UTX) 80
Cartoon Network 86
Century 21 Real Estate 61
Cephalon (CEPH) 94
Charlotte Motor Speedway 86
China Everbright 4
China Resources 4
Chiron (CHIR) 94
Chrysler (C) 76, 86
CIGNA (CI) 42
Cisco Systems (CSCO) 28
Citicorp (CCI) 60, 64, 104
Clein & White 6
CNN 6
Coca-Cola (KO) 35, 46, 64, 69, 90
Colgate-Palmolive (CL) 11, 69
Collect America 74
Colorado Rockies 38
Columbia/HCA Healthcare (COL) 32
Commercial Financial Services 74
Compaq Computer (CPQ) 34, 42
Compensation Resource 64
Computer Data Systems (CSDI) 78
Computer Horizons (CHHZ) 78
ConAgra (CAG) 28
Conference Board 25, 101
Corning (GLW) 64, 104
Cowen 80
CUC International (CU) 61
Cummins Engine (CUM) 76
Cyrus (CYRX) 42

D

Daewoo 46

D'Arcy Masius Benton & Bowles 35

Dassault Systèmes 34
Dell Computer (DELL) 34
Deloitte & Touche 64
Delta Air Lines (DAL) 64
Detroit Diesel (DDC) 86
DFI 86
Digital Equipment (DEC) 34
Donna Karan International (DK) 42
Donnelley (R.R.) (DNY) 64
DRI/McGraw-Hill (MHP) 24, 28
Duff & Phelps 74
DuPont (DD) 86

E

Eastman Kodak (EK) 86, 97
eBay 98
Electronic Data Systems (EDS) 81, 90
Enron (ENE) 46, 104
ESPN (DIS) 86
Esprnt Holdings 4

F

Ferns Baker Watts 78
First Chicago (FCN) 64
First Union (FTU) 74
Ford (F) 46, 61, 64, 86, 104
Fox (NWS) 86
Fujitsu 42
Furman Selz 34

G

Gaines (Jay) 69
Galaxy Investors 60
Galeo Toys (GAL) 4
Gap (GPS) 4
General Electric (GE) 46, 64, 69, 104
General Motors (GM) 46, 64, 80, 86
Gillette (G) 64
GKN 57
Goldman Sachs 11
G.P. Association of Long Beach (GPLB) 86

H

Haggie Online 98
Hasbro (HAS) 4
Hayes Microcomputer 42
Healthsource (HS) 42
Heidrick & Struggles 38
Heinz (H.J.) (HNZ) 64
Hertz (HRZ) 61
Hewlett-Packard (HWP) 34, 81
HFS (HFS) 61
Home Shopping Network (HSN) 98
Honda (HMC) 86

I

IBM (IBM) 34, 69, 81, 90
Inspal 42
ING Barings 4
Intel (INTC) 34, 42
International Comfort Products (ICP) 80
International Data 34
International Speedway (ISCA) 86
Internet Shopping Network 98
ITT (ITT) 64

J

James (Raymond) 86
Julius (Joyce) 86

K

Kamaz 76
Keane (KEA) 78
Kellogg (K) 46, 86
Kirshenbaum Bond & Partners 35
Klik-Klok Online Dutch Auction 98
Kohlberg Kravis Roberts 76
KPMG Peat Marwick 30

L

Lamalle Amrop 69
Legg Mason Wood Walker 78
Lehman Brothers (LEH) 61
Lens 64
Litton Industries (LIT) 78
Lockheed Martin (LMT) 34, 78
Lufthansa 46

M

Major League Baseball 6, 38
Mallin Resources (MLRC) 80
M&M/Mars 35
Mattel (MAT) 4
McDonald's (MCD) 86
McDonnell Douglas (MD) 64, 42
McGraw-Hill (MHP) 101
MCI Communications (MCIC) 33, 42
McKinsey 64
Medtronic (MDT) 97
Mercedes-Benz (DAI) 46, 86, 104
Merck (MRK) 64
Metro-Dade Homestead 86
MGM 60
Microsoft (MSFT) 34, 64, 86
MMS International (MHP) 101
Modi Group 46
Morgan Grenfell 80
Morgan (J.P.) (JPM) 42
Motorola (MOT) 16
Mylan Laboratories (MYL) 80

N

Nabisco (RN) 35
Nashville Network 86
National Semiconductor (NSM) 42
Netscape Communications (NSCP) 28
New Line Cinema (TWX) 60
New Millennium Investors 60
New York Life Insurance 42
New York Yankees 6
News Corp. (NWS) 60
Nike (NKE) 38
Nomura Securities 4, 28
North Carolina Motor Speedway 86
Nynex (NYN) 33

O

Onsale (ONSLE) 98
Open Source Systems 11
Oppenheimer 80
Optek Technology (OPTT) 80
Owens Corning (OWC) 64

P

Panda Estates Investment 84
Parametric Technology (PMTC) 34
Pendleton James 69
Penske Motorsports (SPWY) 86
PepsiCo (PEP) 64, 69
Peugeot 46, 86
Phoenix International Raceway 86
Pittsburgh Pirates 6
PolyGram (PHG) 60
Porsche 86
Protection One (ALRM) 42

Q

Quaker Oats (OAT) 38, 64
Quarterdeck Investment Partners 78

R

Rainbow Child Care & Learning 97
Ralston Purina (RAL) 64
Ramada Franchise Systems
Rank Xerox 46
Raytheon (RTN) 64
Reebok International (RBK)
Regional Financial Associates
Renault 86
Revlon (REV) 46
Rhône-Poulenc Rorer (RPR)
RJR Nabisco (RN) 81
Royal Dutch/Shell Group (RD)

S

Sabre Group 28
SairGroup 61
Salomon Brothers (SB) 80
Sara Lee (SLE) 64
SBC Communications (SBC)
Scott Paper 64
Sears (S) 80
Seattle Manners 38
SGS-Thomson Microelectronics (STM) 42
Shepherd Bueschel & Provost
Silicon Graphics (SGI) 11, 3
SmithKline Beecham (SBH) 64, 104
SoftImage 34
SolidWorks 34
Somnus Medical Technologies
Sony (SNE) 6, 60
Speedvision 86
Speedway Motorsports (TRK) 90
SpencerStuart 64
Sprint (FON) 33
Standard & Poor's 74
Stanley Works (SWK) 64
Structured Finance Advisors
Sun Microsystems (SUNW) 24
Suzuki Motor 46

T

Tatneft 76
Texaco (TX) 34
Texas Motor Speedway 86
3M (MMM) 97
Time Warner (TWX) 60
Toronto Blue Jays 38
Turner Broadcasting (TBSA) 7
Twentieth Century Fox (NWS) 1

U

Unilever (UL) 46
Unisys (UIS) 64
United Technologies (UTX) 6
Universal Studios 60

V

Vanguard Group 30
Visa 38, 42
Vneshtorgbank 76

W

Walt Disney (DIS) 46, 60, 64
Warner-Lambert (WLA) 94
Western Resources (WR) 42
Wheat First Butcher Singer
Whirlpool (WHR) 64
Wieden & Kennedy 35
WorldWide Access 97

X

Xerox (XRX) 81

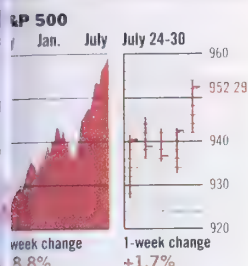
Y

Yahoo! (YHOO) 42

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Investment Figures of the Week

MARKETS

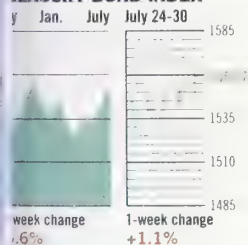


COMMENTARY

Positive earnings surprises came off the wires, and investors were exuberant. The markets, already in a good mood from last week's assessment of the economy by Fed Chairman Greenspan, reacted to news of a budget accord and reports of little inflationary pressure by selling the Dow Jones industrial average to a new high. The Standard & Poor's 500-stock index also rose to uncharted heights, at 952, and the NASDAQ Composite Index sprinted to a record 1588. Falling bond yields added fuel to the rally as long-term yields sank to 6.33%.

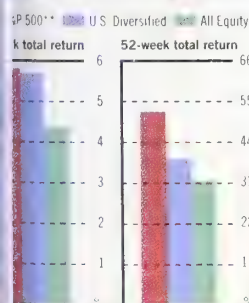
INTEREST RATES

TREASURY BOND INDEX



Bloomberg Financial Markets

MUTUAL FUNDS



Morningstar, Inc.

U.S. MARKETS

	Latest	% change Week	% change Year
Dow Jones Industrials	8254.9	2.1	49.3
NASDAQ Combined Composite	1588.1	1.3	47.0
S&P MidCap 400	313.6	2.1	42.7
S&P SmallCap 600	170.8	1.5	37.8
S&P SuperComposite 1500	203.7	1.7	48.6

SECTORS

	Latest	% change Week	% change Year
Bloomberg Information Age	298.3	0.7	56.5
S&P Financials	111.0	4.8	69.5
S&P Utilities	201.2	1.8	8.8
PSE Technology	323.7	-0.3	70.2

FOREIGN MARKETS

	Latest	% change Week	% change Year
London (FT-SE 100)	4927.3	1.1	33.1
Frankfurt (DAX)	4421.7	0.4	78.8
Tokyo (NIKKEI 225)	20,212.8	0.4	-2.3
Hong Kong (Hang Seng)	15,983.2	1.6	49.6
Toronto (TSE 300)	6850.6	1.3	39.8
Mexico City (IPC)	4974.2	4.9	66.5

FUNDAMENTALS

	Latest	Week ago	Year ago
S&P 500 Dividend Yield	1.59%	1.60%	2.24%
S&P 500 P/E Ratio (Last 12 mos.)	23.7	23.4	18.3
S&P 500 P/E Ratio (Next 12 mos.)*	19.1	19.0	NA
First Call Earnings Surprise*	2.39%	2.55%	NA

TECHNICAL INDICATORS

	Latest	Week ago	Reading
S&P 500 200-day average	796.0	790.0	Positive
Stocks above 200-day average	81.0%	80.0%	Negative
Options: Put/call ratio	0.45	0.45	Negative
Insiders: Vickers Sell/buy ratio	2.90	2.83	Negative

Data: Bloomberg Financial Markets; *First Call Corp.

BEST-PERFORMING GROUPS

	Last month%	Last 12 months%
Homebuilding	30.1	124.6
Computer Systems	24.3	119.9
Semiconductors	20.7	110.5
Communications Equip.	16.7	105.6
Department Stores	16.5	101.2

WORST-PERFORMING GROUPS

	Last month%	Last 12 months%
Money Center Banks	-9.4	-15.6
Hospital Management	-9.2	-6.7
Defense Electronics	-9.2	3.4
Photography/Imaging	-6.6	4.4
Metal & Glass Containers	-4.3	7.1

BLOOMBERG MONEY FLOW ANALYSIS

Rebound ahead? Stocks with most significant buying on price weakness

	Price	1-month change
Nynex	54 ⁵ / ₁₆	-2 ⁴ / ₁₆
Ameritech	67 ⁷ / ₈	-1 ¹ / ₁₆
Bell Atlantic	71 ⁷ / ₈	-4
U S West Communications	36 ¹ / ₂	-1 ³ / ₁₆
Sprint	49 ¹ / ₁₆	-3 ¹ / ₁₆
Toys 'R' Us	34 ¹ / ₈	-7 ¹ / ₈

Decline ahead? Stocks with most significant selling on price strength

	Price	1-month change
Intel	88 ¹ / ₈	17 ⁷ / ₃₂
Microsoft	139 ¹⁵ / ₁₆	13 ⁹ / ₁₆
Dell Computer	80 ⁷ / ₈	22 ³ / ₃₂
Amgen	58 ¹⁵ / ₁₆	13 ¹ / ₁₆
Ascend Communications	53 ¹ / ₈	13 ³ / ₄
Sun Microsystems	45 ¹ / ₁₆	8 ¹⁵ / ₃₂

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 31% federal tax rate.

	10-yr. bond Latest week	10-yr. bond Last week	30-yr. bond Latest week	30-yr. bond Last week
GENERAL OBLIGATIONS	4.48%	4.53%	5.06%	5.10%
PERCENT OF TREASURIES	74.20	73.72	80.04	79.33
TAXABLE EQUIVALENT	6.49	6.57	7.33	7.39
INSURED REVENUE BONDS	4.64	4.67	5.30	5.32
PERCENT OF TREASURIES	76.85	75.99	83.84	82.75
TAXABLE EQUIVALENT	6.72	6.77	7.68	7.71

EQUITY FUNDS

Leaders	Laggards
Four-week total return	Four-week total return
%	%
Fidelity Select Computers	Invesco Strategic Gold
18.1	-9.8
Lexington Troika Russia	Van Eck Gold Opport. A
17.1	-8.7
Steadman American Industry	Gabelli Gold
16.9	-8.6
Robertson Steph. Info. Age A	Morgan Stan. Inst. Gold A
16.9	-8.3
Delaware Aggressive Gr. A	Midas
15.3	-8.2
Leaders	Laggards
52-week total return	52-week total return
%	%
Lexington Troika Russia	Frontier Equity
151.3	-45.0
ITT Hartford Cap. Apprec. A	United Svcs. Gold Shares
98.9	-43.8
Fidelity Select Electronics	Bull & Bear Gold Investors
88.2	-40.4
Pioneer Growth A	Morgan Stan. Inst. Gold A
79.8	-39.4
American Heritage	Lexington Strategic Invmts.
78.7	-37.2

EQUITY FUND CATEGORIES

Leaders	Laggards
Four-week total return	Four-week total return
%	%
Technology	Precious Metals
10.8	-5.0
Large-cap Growth	Pacific/Asia ex-Japan
7.1	0.6
Mid-cap Growth	Japan
6.7	0.6
Financial	Diversified Pacific/Asia
6.1	0.8
Mid-cap Blend	Foreign
5.7	1.4
Leaders	Laggards
52-week total return	52-week total return
%	%
Financial	Precious Metals
58.6	-24.5
Latin America	Japan
54.8	-1.8
Technology	Diversified Pacific/Asia
50.5	10.8
Large-cap Growth	Pacific/Asia ex-Japan
46.2	16.9
Large-cap Blend	International Hybrid
45.3	21.7

are as of market close Wednesday, July 30, 1997, unless otherwise indicated. Industry include S&P 500 companies only. Fundamentals, technical indicators, Bloomberg mon-

ey flow analysis, and mutual fund returns are as of July 29. For a more detailed explanation, write to us or E-mail figures@businessweek.com. NA=Not available **Vanguard Index 500 Fund

THE BUDGET DEAL: A LOST OPPORTUNITY

Good economic times are yielding dubious fiscal policy, while bad times gave us good fiscal policy. Perhaps that's not so surprising. Still, it's disappointing that politicians, reaping the benefit of a revenue windfall to the U.S. Treasury following years of hard-won fiscal restraint, have chosen this time to complicate the tax code and keep plenty of pork in the budget. The reduction in the capital-gains tax rate is of doubtful economic value at this bullish moment, education credits will simply induce educational institutions to hike tuition, and some noxious subsidies to industry have been retained.

To be sure, we like parts of this budget, such as the \$275 billion reduction in projected spending over the next five years, the allocation of \$24 billion in much-needed health insurance for children, and expanded savings incentives. No question, the agreement is a political landmark: This was supposed to be the era of gridlock in Washington. Instead, President Clinton and Congress are rushing to take credit for each other's ideas.

Our preference would have been to simplify the tax code by introducing fewer and lower marginal tax rates, broadening the tax base, and closing loopholes rather than opening up new ones. We suspect, though, that as long as U.S. economic growth continues at about 3%, this budget deal is affordable. But there's no guarantee that such growth can carry on indefinitely, and it would have been better to strike a budget deal that promoted long-term growth and budget balance. Deeper reforms—such as smaller cost-of-living adjustments for Social Security and income-based premiums for Medicare—are yet to be tackled. We hope politicians have the will to pursue tough fiscal policies while the economic backdrop is still favorable, the better to ensure that it remains so.

HOW TO PICK THE RIGHT CEO

Not many chief executives spend time wondering who their successors will be. That's understandable: It's human nature to think that, if you're top dog, no one else can do the job. But it's clear that Corporate America will have to take succession planning more seriously. The recent departure of Gilbert F. Amelio from the No. 1 slot at Apple Computer Inc. and the resignation of John R. Walter from the corporate suite at AT&T show how badly awry the process of choosing leaders can go. With corner offices slated to open up within the next few years at such companies as General Electric, Ford, and Citicorp, the search for talent is on.

Today, a few forward-looking executives and directors are showing how best to orchestrate the selection. An intricate, six-month process at Campbell Soup Co. elevated internal can-

didate Dale F. Morrison to the position of president and on July 15. Campbell's board, which *BUSINESS WEEK* named Best Board in America last year, undertook an elaborate screening of two internal candidates and three external ones, conducting many interviews, background checks, and discussions within the search committee—without then-CEO D. W. Johnson present to influence the outcome. Contrast that with AT&T Chief Robert E. Allen's meddling involvement in Walter's selection less than a year ago.

Campbell's selection process was brought about in part by nudging from Johnson, an outsider hired by Campbell in 1990 to shake things up. Indeed, the CEO can set the tone for planning, just as for all other aspects of business. GE's John Welch has made succession a clear priority by rotating more than a dozen aspirants through numerous assignments and challenges, making sure they have frequent contact with company directors. At Corning Inc., the CEO and board meet annually to consider candidates, while at SmithKline Beecham promising executives are moved through a series of rotations so that they can boast experience in two business units, two functional areas, and two countries. Corporate boards would do well to follow the example of Campbell and others as they select new leaders.

HEADED FOR INDIA? LEARN THE ROPES

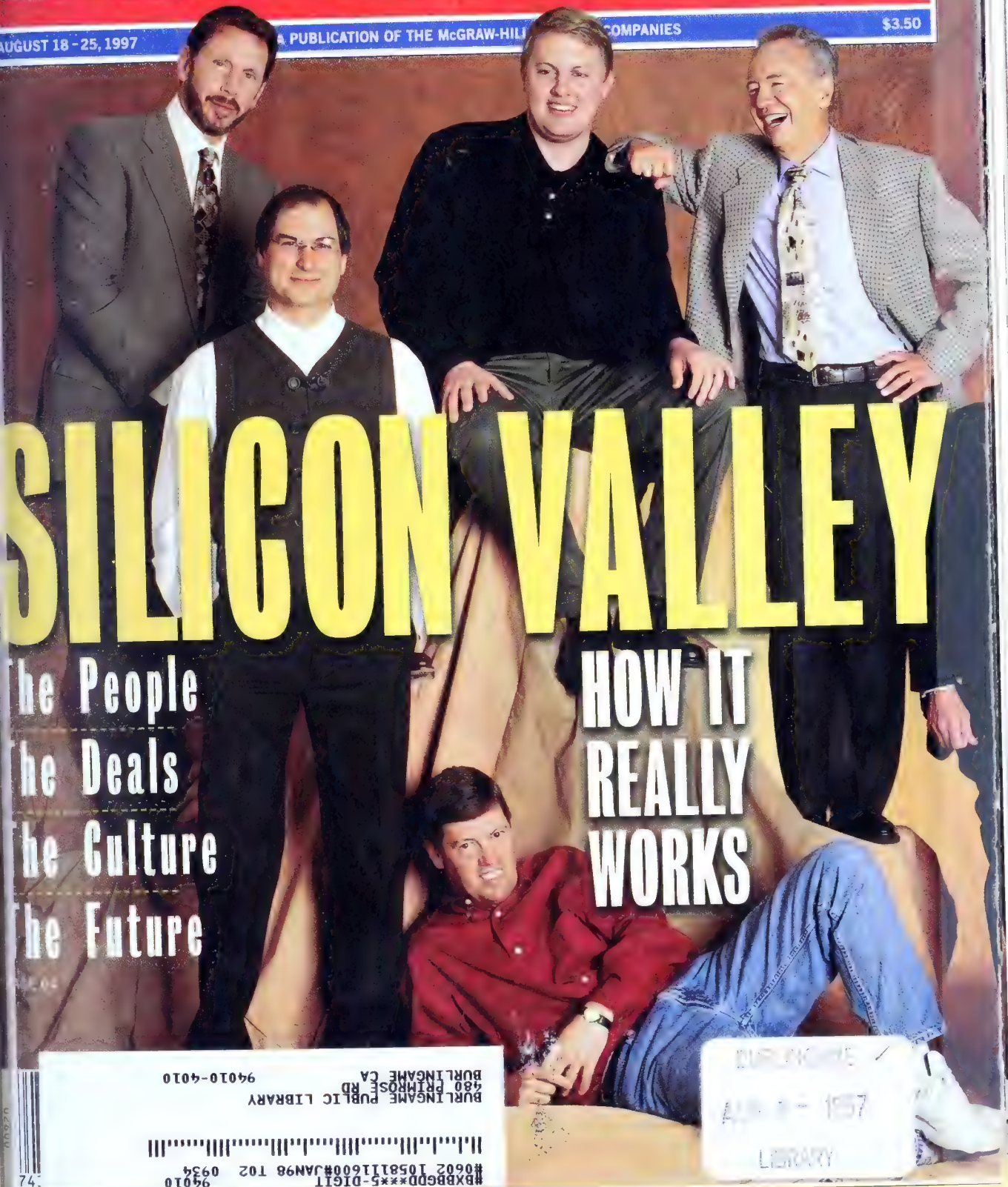
Nearly 1 billion people. A middle class of 250 million. Many multinational companies, that has been the dream of India since its government began to deregulate the economy and welcome foreign investment six years ago. What seemed at first to be a vast market promising easy profits has turned out to be a complex, multifaceted society with many obstacles to successful investment. General Electric Co. and a few others seem to have made the right move. But more common are the blunders, such as Mercedes-Benz's foray into local production of its E-class sedan with a plant now running at 10% of capacity.

To be sure, the government could do more to deregulate the economy and streamline the bureaucracy. But multinationals must take a less naive approach. Widely held assumptions about the size of India's middle class are wrong. Indian economists put it at closer to 100 million. Then, too, India is exceedingly diverse, with 25 states, 17 official languages, and 6 major religions. Manufacturers shouldn't expect their products to go over equally well with all groups.

Years of colonial rule have made Indians sensitive to foreign incursions. Enron Corp.'s pursuit of a power project alienated Indians: Enron got bogged down in 24 court cases—even though it eventually won them all. Other companies failed to do their research—and wound up investing with feuding local partners, for example. GE and a handful of other investors, meanwhile, did extensive homework on their potential markets and partners. For investors in India, "proceed with caution" should be words to live by.

BusinessWeek

AUGUST 18 - 25, 1997 A PUBLICATION OF THE MCGRAW-HILL COMPANIES \$3.50



SILICON VALLEY

he People
he Deals
he Culture
he Future

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A dozen of the Valley's
brightest stars:
(top row, left to right)
Larry Ellison, Oracle;
Marc Andreessen,
Netscape; Andy Grove,
Intel; Al Shugart,
Seagate Technology;
Gordon Moore, Intel;
John Chambers,
Cisco Systems
(bottom row, left to right)
Steve Jobs,
Apple Computer, Pixar;
Scott McNealy,
Sun Microsystems;
John Deerr, Kleiner
Perkins Caufield & Byers;
Larry Sonsini,
Wilson Sonsini
Goodrich & Rosati;
Lew Platt,
Hewlett-Packard;
Jim Clark, Netscape

SILICON SAGA

It has been 40 years since a group of engineers, including the legendary Gordon Moore and Robert Noyce, joined six others to found Fairchild Semiconductor, a pioneer in working exclusively with a simple material called silicon. The rest, as they say, is history. But what a history—the fascinating saga of how the orchards around Fairchild's headquarters in Mountain View, Calif.,

eventually blossomed into the hotbed of the Information Age.

Silicon Valley is a true melting pot, with immigrants from all over the world providing much of the intellectual firepower.

Andy Grove, for example, an émigré from Hungary, teamed up with Moore and Noyce to build Intel Corp. into a superstar.

But in many ways, the Valley is quintessentially American: the romantic entrepreneurialism of Henry Ford and Thomas Edison recreated by, among others, Steve Jobs and Steve Wozniak starting Apple Computer Inc. in a garage.

We have been telling parts of this story regularly over the years. When we launched our Information Processing department in the 1970s, I'm proud to say, we were the first noncomputer magazine to institute a regular section to cover the burgeoning hardware and software industries on a weekly basis. Since then, we have run scores and scores of cover stories and special reports on information technology and won well more than our share of editorial prizes for computer coverage.

So it was not a tough call to decide what to write about in this, BUSINESS WEEK's first-ever special summer double issue: The story of what really makes Silicon Valley tick in the 1990s—the story of the people, the culture, the deals, and the technology. For our gatefold cover photograph, we got a dozen stars of Silicon Valley together in one room and asked them to ham it up a bit when they said cheese. In typical

Silicon Valley fashion, they happily agreed.

The whole project was headed by Kathy Rebello, who just last April became the senior editor in charge of BUSINESS WEEK's information technology coverage. Kathy is perfectly suited for the multitasking involved here. A graduate of San Jose State University, she has lived in the Valley since 1985. She joined our San Francisco bureau in 1991, became bureau chief in 1995, then moved the six-person bureau to San Mateo to be closer to the high-tech action. Since becoming a senior editor, she splits her time between New York



REBELLO



**WE KNEW THEM WHEN:
APPLE'S WOZNIAK AND
JOBS IN 1981 AND INTEL'S
GROVE, NOYCE, AND
MOORE IN THE 1970s**



and San Mateo. The distinctive look of this Special Issue was created by Senior Art Director Francesca Messina. Associate Picture Editor Ronnie Weil handled the photography.

This being the Information Age, we decided not to restrict our Silicon Valley presentation to print. We have cooperated with the CNBC cable television network, which will be running complementary stories for a week beginning on Aug. 8. And our

Web site, at www.businessweek.com, will feature plenty of information that's not contained in the magazine, including an interactive list of the Valley's biggest public companies and transcripts of key interviews. The region that is behind so many of today's innovations deserves nothing less than multimedia treatment.

Stephen B. Shepard

Editor-in-Chief

BusinessWeek

AUGUST 25, 1997

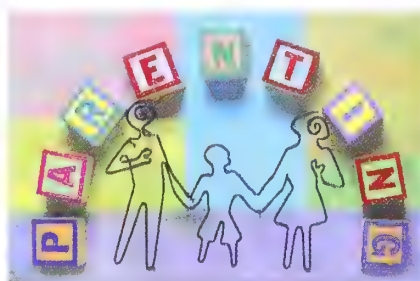
THE TOBACCO DEAL

Will the billions be spent wisely? page 36

KIDS' STUFF

Smart ads for Mom and Dad

page 192



SHINY QUARTER

Even with growth slightly off, the profit picture is bright

page 15



HEAVY PACKAGING

The Teamsters may have chosen the wrong opponent when it struck UPS

page 40

News: Analysis & Commentary

- 36 **THE TOBACCO DEAL**
Will it create a policy nightmare?
- 38 **DETROIT APPLIES THE BRAKES**
Carmakers finally put a lid on prices
- 40 **UPS VS. THE TEAMSTERS**
Why Ron Carey has an uphill battle
- 41 **CAREY VS. HOFFA: CLEAN ELECTION?**
- 42 **COMMENTARY: PRODUCTIVITY**
The great numbers are still a mystery
- 44 **IS THIS APPLE'S GRAND PLAN?**
Gates and a new board may not suffice
- 44 **OXFORD'S NOT-SO-BAD NEWS**
CEO Wiggins quits but will stick around
- 46 **COMMENTARY: DRUGMAKERS**
How big brands trounce the generics
- 47 **A HOT SUMMER FOR HOME SALES**
As rates dip, mortgage applications rise
- 47 **AN AVALANCHE OF IRAS?**
The tax deal may spawn little business
- 48 **PUTSCH ON THE POTOMAC**
The businessman trying to run D.C.
- 50 **IN BUSINESS THIS WEEK**

International Business

- 54 **CHINA**
Beijing's next big push: Privatization
- 56 **ISRAEL**
Trying to shape Koor into a global force
- 57 **GERMANY**
Business bristles at Bonn's tax dithering
- 58 **ARGENTINA**
Suddenly, investors snap up farmland
- 61 **INTERNATIONAL OUTLOOK**
Will corruption charges stick to Arafat?

Economic Analysis

- 28 **ECONOMIC VIEWPOINT**
Kuttner: Stub out the tobacco deal
- 32 **ECONOMIC TRENDS**
- 33 **BUSINESS OUTLOOK**

Finance

- 148 **THE RICH GET A LITTLE RICHER**
Hedge-fund players trail the S&P
- 149 **DID THIS LENDER GET TOO HUNGRY?**
Cityscape's hard sell is under fire

152 SPECULATION 101: CHASE-MERRILL

The pros and cons of joining forces

154 SCUDDER'S HEAVY BAGGAGE

It's stuck with Kemper's mutual fund

156 INSIDE WALL STREET

201 INVESTMENT FIGURES OF THE WEEK

Corporate Scoreboard

158 'THINGS STILL LOOK AWFULLY GOOD

Slower growth is more likely to

160 IT'S NOT A SUPERDOLLAR YET

The buck rises, but not to '80s highs

Personal Business

192 MINDING THE KIDS

A dual income vs. someone at home with children and money, finding a balance

Features

- 1 **EDITOR'S MEMO**
- 4 **UP FRONT**
- 13 **READERS REPORT**
- 17 **BOOKS**
- 24 **TECHNOLOGY & YOU**
- 53 **WASHINGTON OUTLOOK**
- 200 **INDEX TO COMPANIES**
- 202 **EDITORIALS**

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PRODUCTION

IDE SILICON VALLEY

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the epicenter of global technology?
INESS WEEK offers an in-depth look

W IT REALLY WORKS

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L GATES' LONG SHADOW

h executives never forget who's the
7 to beat

OVERS & SHAKERS

TOP 25 POWER BROKERS

u know who the kings are. Now,
et the kingmakers

99 STARTING OVER—AND OVER

Take the money and run? Not here,
where entrepreneurs delight in finding
new worlds to conquer

102 LOVE AMONG THE DIGERATI

This must be the real thing: A couple
that has survived three startups

106 THE GREAT HUNT FOR HOT IDEAS

A day in the life of a high-tech venture
capitalist: The dealing never stops, and
neither does the schmoozing

123 A MELTING POT OF GOLD

In the Valley, at least, the American
Dream is alive and well

THE CULTURE

124 FROM PIP-SQUEAKS TO PLAYERS

The IPO has done wondrous things for a
number of struggling startups, and its
appeal isn't fading

126 MY JET IS BIGGER THAN YOUR JET

How much has wealth changed the lives
of the area's *nouveaux riches*?

130 MILLIONAIRE RECEPTIONISTS

Stock options and equity offers trickle
all the way down

134 TOO MUCH OF A GOOD THING?

The Valley's boom makes it tough to
live, raise a family, and run a business

136 WHERE WOMEN ARE INVISIBLE

The declining number of female
engineers isn't the only problem

BEYOND THE VALLEY

138 MUST BE SOMETHING IN THE WATER

Many regions have tried to duplicate
the Valley's magic. Few have succeeded

139 TAIWAN'S NEW GRAIL: INNOVATION

The island is trying to develop its own
creative genes through research

142 A MALAYSIAN MIRACLE?

Prime Minister Mahathir Mohamad's
vision is of a multimedia super corridor

144 THE HALLOWED HALLS OF HIGH TECH

In Cambridge, homegrown companies
flourish—and push down unemployment

146 HOW TO MAKE THE MAGIC TRAVEL

Much of what works in Silicon Valley
can work for companies of all stripes

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available. For information and prices, call
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Up Front

EDITED BY PAT WECHSLER

GREAT RATE DEBATE

THE FCC SPARKS A GLOBAL HISSY FIT

U.S. CALLERS COULD BE in line to save some money when the Federal Communications Commission approves rules to lower international calling rates, expected as early as August 7. But not everyone is smiling.

Many nations—including Italy, Japan, Australia, Trinidad-Tobago, and Latvia, to name a few—are criticizing the FCC for its unilateral action. These countries insist that phone charges should be set by the International Telecommunication Union in Geneva. This multinational regulatory body, however, has dragged its feet on the subject, frustrating FCC chief Reed Hundt.

So the feds put the process in motion last December with a proposed rule to lower carrier-to-carrier rates from 88¢ a minute to between 15¢ and



HUNDT: Most unfavored nabob

23¢. The commission also says that it will block foreign carriers from entering the U.S. market if they don't comply with the lower rates. This has enraged many, including the Japanese. "Japan thinks that's against the [principles of] the World Trade Organization," says Embassy official Junichiro Miyazaki.

The cost of this overcharge to a nation of immigrants who love to phone home: \$5.4 billion annually. *Catherine Yang*

SPORTS BIZ

BINOCULARS, ANYONE?

WHEN THE U.S. OPEN tennis tournament kicks off Aug. 25, it may not be the players having tantrums. More likely, it'll be the fans.

The problem? Many people hate their seats. In the new Arthur Ashe Stadium in Flushing, N.Y., 30 feet of luxury boxes has relocated loyal and usually affluent fans to the upper deck. In the old stadium, they sat closer. Tennis buffs are so irate that several have filed complaints with the state's Attorney General, who is investigating ticket



SAMPTRAS: Or is it?

scams at New York arenas and theaters. "They built a new stadium with more seats, and everybody gets moved 50% farther from the court," grouches Rockwell International general counsel William Calise, one angry fan.

Calise might ask his own company why he's sitting in the cheap seats (\$3,515). Corporations gobbled up all 89 luxury suites, costing between \$85,000 to \$100,000. Also

scooped up at \$8,000 a pop were seats just above the suites. Fans gripe that they were never given a shot at those better spots. Open officials are telling unhappy campers to turn in tickets by Aug. 15 and get a refund.

Brad Wolverton

TALK SHOW "This has happened a thousand times before so it's not worth making a fuss about."

—Deputy Flight Director Viktor Blagon, referring to the loss of oxygen tanks on the *Mir* space station

HONCHOS

THE INSIDE DOPE ON OUTSIDE CEOs

EVERYONE KNOWS THAT Louis Gerstner Jr. has turned around IBM since arriving as an outside CEO four years ago. But with the recent failures of outsiders at AT&T and Apple Computer, does recruiting outsiders really make sense?

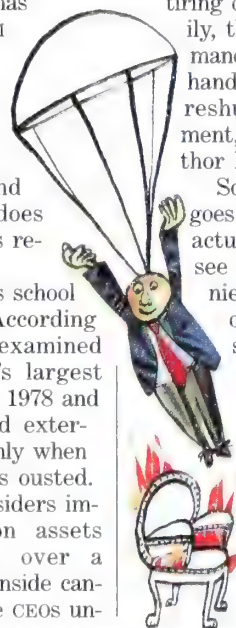
Harvard business school says it depends. According to research that examined 200 of the nation's largest companies between 1978 and 1992, a CEO drafted externally has an edge only when his predecessor was ousted. In those cases, outsiders improved returns on assets 3.6% on average over a three-year period. Inside candidates who become CEOs un-

der similar circumstances produced no improvement.

Why? An outsider brings in badly needed fresh perspective, the study concludes. But in the case of a CEO tiring or leaving voluntarily, the outsider lacks the mandate for change. He handcuffs his ability to reshuffle top management," says study co-author Rakesh Khurana. So when a transition goes smoothly, outsiders actually tend to oversee declines at companies—5% on average over three years; insiders eke out a 1.5% gain.

The researchers surmise that knowing a company and its markets is a big edge only if a big change isn't needed.

John Byrne



PHONE WARS

SAN DIEGO KISSES A BABY BELL BYE-BYE

IN A MAJOR BOOST FOR competition in local phone markets, the city of San Diego plans to pull all of its local telephone business from Pacific Bell and give it to Teleport Communications Group. The deal, which was scheduled to be announced on Aug. 13, marks the first time a

nunziata, have picked up many business customers. The San Diego deal marks a significant victory for not only the new local provider but also the 1996 Telecommuni-



ANNUNZIATA: Dereg hero

top-10 U.S. city has dropped its incumbent Bell to get service for municipal offices.

With \$283.3 million in revenues, the Staten Island (N.Y.)-based Teleport is one of the upstart providers attempting to chip their way into local markets. So far, companies such as Teleport, headed by aggressive CEO Bob An-

tions Act, which has been roundly criticized for failing to increase the level of competition in local markets fit enough.

To Teleport, the six-year contract with the nation's sixth-largest city, San Diego County, and local schools is expected to be worth a minimum of \$30 million. For San Diego, the switch from Pacific Bell, now owned by SBC Communications, is expected to mean discounts of 20% to 30%. *Peter Elstrom*



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Up Front

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NICE BOUQUET, FULL-BODIED PRICES

INFLATION MAY BE UNDER control, but not when it comes to fine old Bordeaux. Because of bad harvests this decade, these reds of the late 1980s and 1990 from select châteaux are in hot demand and at very high prices.

Few are more aware of this than Alan Stillman. He is proprietor of the New York Restaurant Group, owner of eight New York eateries, including the well-known steakhouse Smith & Wollensky, which plans to open restaurants in Miami and Chicago this fall. With his 75,000-bottle cellar, Stillman has accumulated wines for years for use in his restaurants. But in the past few months, he came to realize that many—his '89 Pétrus, '85 Lafite-Rothschild,



STILLMAN: *Liquid assets*

and '87 Opus One, to name three, all of which he bought for around \$100 a bottle—should now sell for more than \$1,000. "We've won this award and that award for our wine collection," Stillman says. "But no one's walking into a restaurant and paying \$1,200 for a bottle." So he decided to put 50 cases up for auction through Zachys/Christie's beginning September. Stillman expects to reap more than \$100,000 for his bottles, then use it to buy less expensive vintages. First he may treat himself to one of his high-priced wines. But at about 82¢ a sip, he says, it may be a little hard to swallow. □

THE BIG PICTURE

BANKING JOBS MAY BOUNCE BACK

Commercial banks are hiring again for the first time in years. That's largely thanks to a looser regulatory climate in which banks can do everything from selling mutual funds to underwriting debt.



FOOTNOTES Fast-growth U.S. companies in strategic alliances: in 1996, 61%; in 1993, 55%

DRAWN & QUARTERED

Only the pen can conquer the sword.



IN VOGUE

TEA IS BAGGING A BIGGER CROWD

READ THE TEA LEAVES THESE days and they point to a rise in the drink's nationwide popularity. Tea is so trendy that some purveyors, including tea-bag king Lipton, are opening tea houses offering more exotic blends.



NEW LEAF: *Brisk sales*

Frenetic Americans see tea—with its lower caffeine content—as a healthful substitute to coffee, according to tea-house proprietors. And almost predictably, these new establishments have their

biggest presence on the West Coast. Lipton opened its first tea house in Pasadena, Calif., in December. "People are asking for Lipton tea bags. They want Lipton's from Sri Lanka," says Peter Goggin, Lipton's director of tea buying. The Tea Council estimates there are now 1,000 tea houses in the U.S.

Sales of tea nationwide have risen from \$1 billion in 1990 to \$4.2 billion last year. While coffee, at \$6.5 billion in annual sales, is the buzz choice, tea is gaining. Even java-sellers, such as Starbucks and Peet's, have felt the need to expand their selection of teas. Seanna Browne

HALLS OF IVY

PUBLISHERS GET A CAMPUS HAZING

WHEN STUDENTS HEAD TO the college bookstore every fall, they face a hard economics lesson: Textbooks are a big expense. College stores are trying to do something about that in an antitrust lawsuit, charging three leading textbook publishers with giving better discounts to retailers than to campus stores.

Filed on July 23 in U.S. District Court in Manhattan, the suit by the National Association of College Stores claims that Cambridge University Press, Oxford Uni-



STUDENTS: *Price prisoners*

versity Press, and Addison Wesley Longman rarely give academic bookstores any more than 20% discounts, while offering the same books at 50% off to retailers. The

college-store group is now seeking damages. Instead, it is asking for an injunction to end the practice and level the playing field. (The suit does not name BUSINESS WEEK parent, The McGraw-Hill Companies, a major publisher of textbooks.)

The losers, says the suit, are students, who, as a captive audience, are often unable to shop around. Their denial of wrongdoing by the three publishers claims pricing structures are designed to promote academic works to a wider reading audience and not to disadvantage the college stores or students. Gregory Kor

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FED CHEERS RISK MANAGEMENT

In your recent article, "Taking the angst of taking a gamble" (Finance, July), you provide a useful discussion of the management technique called "value at risk" (VAR), in which information about past market volatility is used to quantify an institution's exposure to market movements and gain insights into a portfolio's risk. This measurement approach represents an important effort by the financial community to improve its management of risk in a way that the Federal Reserve supports.

Moreover, contrary to the author's suggestion, the Federal Reserve also encourages the decision by the Bank for International Settlements to build upon results in setting bank regulatory capital requirements. Indeed, we need to bring that standard to the fore and will enforce it as scheduled in 1998, along with our foreign counterparts.

The Federal Reserve's interest in an innovative "precommitment" approach, mentioned in the article, reflects the Fed's desire to find future ways of promoting market discipline and reducing regulatory intrusion, while continually improving its supervisory and regulatory process. However, until better tools are found, basing market risk capital requirements on VAR is a big step forward and one that the Board supports.

Richard Spillenkothen
Director
Division of Banking Supervision
& Regulation
Federal Reserve System
Washington

DA'S CEO: WHAT I DID AT JAGUAR

While I am most appreciative of BUSINESS WEEK's characterization of my abilities and track record, I must correct some errors as they relate to my experience at Jaguar ("The struggle

for Mazda's soul," The Corporation, July 21).

First off, I was not responsible for re-vamping Jaguar's dealer network. Moreover, your facts are incorrect about Jaguar's "poor customer-service scores." Jaguar undertook a major dealer re-vamping in the mid- to early 1980s, which brought about improvements in customer-handling scores long before I arrived in 1993. In fact, when the J.D. Power index was first published in 1986, Jaguar ranked fourth in customer handling, and it has dropped below the top 10 only once since.

As for the question of whether I rode into Mazda on a white horse, I can assure you that the work ahead will be successful only through the dedicated efforts of the entire Mazda team—and that, as it does at Jaguar, includes the dealers.

Richard Beattie
Chief Executive Officer
Mazda North American Operations
Irvine, Calif.

Editors' note: The customer satisfaction scores provided to us by J.D. Power and Associates combined customer handling with vehicle repair and reliability. The scores Beattie cites refer only to the customer handling component of the J.D. Power survey and are not publicly available.

APPLE IS RIPE FOR A MERGER

Prince Alwaleed's statement that Apple Computer should "consider any alliance that makes sense" is right on track ("Is Apple mincemeat?" News: Analysis & Commentary, July 28). In line with its involvement in "distance learning" through the Western Governors University project, Apple should ally itself with the leaders of the budding "technotainment" industry.

What would Apple gain? To paraphrase Steve Jobs, it would be part of an "insanely great" business development. BUSINESS WEEK estimated this spring that this could be a \$100 billion global business.

CORRECTIONS & CLARIFICATIONS

"A slimmer CIGNA," (In Business This Week, Aug. 11) misidentified the buyer of CIGNA Corp.'s life-insurance business. It is Lincoln National Corp., not New York Life Co.

"The big picture" (Up Front, July 14) should have said the health benefits for retirees were paid by their former employers, not their pension plans.

"Why the Donorgate hearings won't lead to reform" (News: Analysis & Commentary, July 21) wrongly said a campaign-finance reform bill introduced by Senators John McCain (R-Ariz.) and Russell D. Feingold (D-Wis.) had no co-sponsors. It should have said the bill has no other Republican co-sponsors, although Senator Susan M. Collins (R-Me.) has agreed to back an amended version.

If Apple Computer follows this strategy, the millions of future computer owners who live in the world's developing countries will have the opportunity to benefit from Apple's inherently user-friendly operating system—still the better mousetrap of the operating-system world.

Steven G. Brant
President
Trimtab Management Systems
Brooklyn, N.Y.

MOURNING VERSACE, NOT JUST HIS EMPIRE

"After Versace" (Cover Story, July 28) was a fine piece of analysis of the Versace empire, and very timely as well, considering that Versace was in the final preparatory stages of an initial public offering that by all accounts would have been enormously successful. However, the story would have been more successful had the authors considered the human element.

Apart from the glamour and paparazzi that were inherently part of Gianni's life, there was the man himself, who made his dreams a reality. Those dreams were cruelly taken away from him with two bullets to the back of the head.

Millard B. Souers Jr.
Falls Church, Va.

CHILE AS AN ECONOMIC MODEL? NO THANKS, MR. ROBERTS

In his column, "Welfare doesn't have to be habit-forming—just look at Chile"

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Readers Report

(Economic Viewpoint, July 28), Paul Craig Roberts' enthusiasms at long last reveal the real political preferences of him and his right-wing political cohorts: military dictatorship.

Unfortunately, using a tactic to which we readers of his columns have become accustomed over time, he distorts the facts and tells only half the story in order to glorify a military government that "had no need to buy votes with handouts" and in order to excoriate a postmilitary democratic government so bold as to propose unemployment insurance, which Roberts equates with "welfare."

First of all, the military government of General August Pinochet did not "step down" but was forced from power after the people finally got a chance to vote on the dictatorship. This was despite the fact that the vote was a Gaullist-style referendum Pinochet set up to ensure another decade of his brutal regime. The people voted in response to a decade and a half of not only political repression but also, contrary to Roberts' mythology of success, economic failure for the vast majority of the Chilean people.

Between 1970 (even before Allende's

socialist government) and 1990, the percentage of national income going to wages fell from 42% to 34%, and the poverty rate rose from 17% to more than 40%.

It seems about time that Roberts, just came out and said what he continues to imply in column after column: Chile and its free-market militarism is his model for the world, including the U.S. In fact, there is no other way to create the kind of "prosperity" that Roberts advocates than to do away with democracy.

Ronald G. Woodbury
State University of New York
Potsdam, N. Y.

Paul Craig Roberts has highlighted Chilean welfare programs as an example for other countries of how to help the poor and the disadvantaged—while avoiding the welfare dependency which, many argue, has developed in industrialized countries. I shall not contest his arguments, but I will contest a specific conclusion he draws at the end of the column. I think it goes beyond a legitimate search for best practice in public policies.

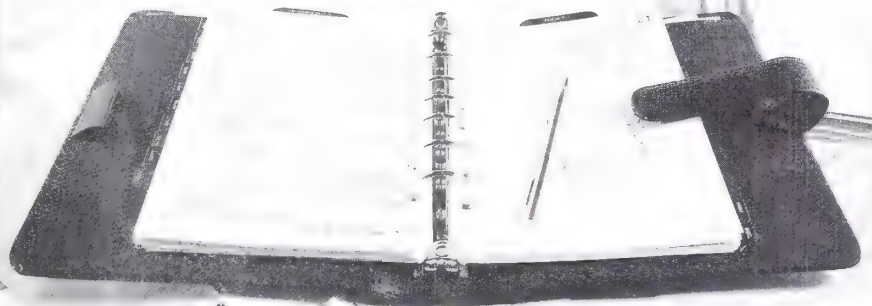
In a nutshell, Mr. Roberts argues that

if Chile has good social policies, it because a military dictatorship guaranteed the political conditions that allow Chicago-trained economists to deliver their agenda. Now that Chile has returned to democratic rule, Mr. Roberts argues, frustrated politicians are attempting to wreck this model by putting forward such proposals as an unemployment insurance system so they will have something "to sell to the electorate for votes."

The main flaw in the columnist's argument lies not in his implicit defense of military rule to achieve public-policy goals but in the facts he quotes to support his hypothesis. Since 1990, free elected officials and legislators in Chile have not only put more resources in efficient social programs but also have launched new initiatives. Among these are training programs for the unemployed—which the columnist wrongly attributes to the military government and the proposals for unemployment insurance themselves.

In the latter case, the proposal that was put forward by the Chilean government sets up a system that protects the unemployed not with transfer funds from the government but with the

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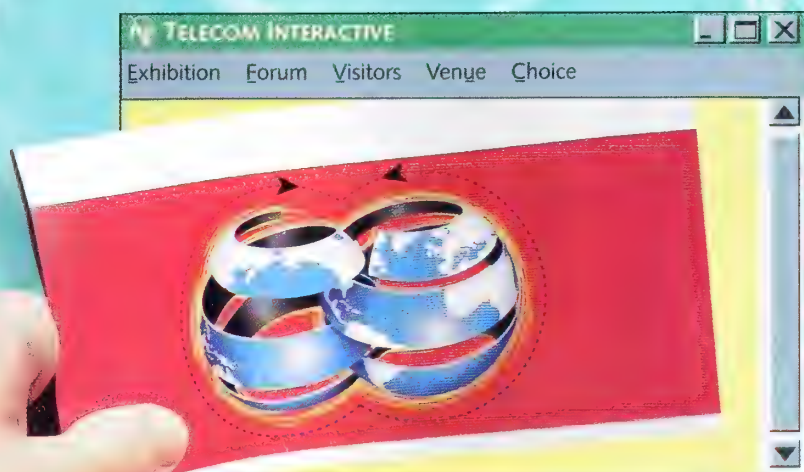
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W o r l d s o f C h o i c e

Readers Report

own savings, accumulated in individual capitalization accounts fed by contributions out of their past wages and managed by private companies. In other words, subsistence during hardship times is not covered by "welfare" but by the past saving effort made by each worker.

I hope this demonstrates that, contrary to Mr. Roberts' beliefs, politicians

can make sound decisions on social policies within a democratic environment. This should come as good news to countries that are not prepared to pay the price of dictatorship to get their public policies right.

Mario Marcel
Executive Director
for Chile and Ecuador
Inter-American Development Bank
Washington

to monitor and share information on criminal activities.

We haven't halted international money laundering. But to suggest that bankers are sitting on their hands in this battle is irresponsible.

Donald G. Ogilvy
Executive Vice-President
American Bankers Association
Washington

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BANKERS ARE FIGHTING THE DIRTY-MONEY WAR

You suggest that bankers need to be pushed into the fight against illegal money laundering ("Know your customer—or else," Finance, July 21). Our industry has been cooperating with federal authorities since 1985. Banks have filed more than 11 million reports with Uncle Sam to report cash transactions over \$10,000 (those most likely to involve dirty money).

The Federal Reserve study you cited concluded that bankers are following "know your customer" procedures. The banking industry, through the American Bankers Assn., has been an active member of a U.S. Treasury Dept. team

HOW TO REACH BUSINESS WEEK

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Short-term fever?

by B. Grady

Oh you've got it alright. Between the sandwich you downed on the freeway to make that meeting on the opposite side of the city, and the mad dash home to catch enough of Tommy's soccer game so as not to be late for Bridget's ballet recital, you're knee-deep in it. Welcome to the short-term world.

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DANGEROUS COMPANY
Consulting Powerhouses and the Businesses They Save and Ruin
James O'Shea and Charles Madigan
\$18 Business • 355pp • \$27.50

SCORNFUL LOOK AT THE CONSULTING BIZ

I heard the one about the consultant who borrows an executive's watch to tell him the time? It's an old joke, and not a very good one. James O'Shea and Charles Madigan, two veteran journalists from the *ago Tribune*, bring exactly that dead point of view to a book that otherwise could have been the most important work on consulting in decades. *Dangerous Company*, their examination of one of the world's booming businesses, is an ill-informed, anticonsultant and filled with grievances that have been leveled at consultants for decades. The book decry the industry's fees, its recycling of old ideas, its willingness to tell clients only what they want to hear, and its penchant for turning raw MBAs into key decision-making roles. But it is hardly news to anyone who has been either a consultant or a beneficiary of a consulting assignment. Meanwhile, they fail to describe how the business really works—and why it has been so successful.

Why should anyone read this book? Despite the missed opportunity to provide a truly penetrating inquiry, the authors do provide a lively overview of an important industry, with chapters on the major players, including Andersen Consulting, Bain, Boston Consulting Group (BCG), and McKinsey & Co. And, despite nearly three decades after the publication of the last significant book-length examination of consulting—Halston's 1969 *The Business Healers—Dangerous Company* does contain some interesting revelations.

The book discloses, for example, that Andersen Consulting's contract with Alabama-based O'Neal Steel Co. provided a fee as for every 100 jobs eliminated.

The authors also recount the story of how conglomerate Figgie International nearly went bankrupt after racking up more than \$75 million in consulting fees in the early 1990s. And they convincingly relate the disturbing tale of how a Bain & Co. consultant turned in one of his own clients, Guinness PLC, for engaging in an illegal stock-manipulation scheme.

To be fair, O'Shea and Madigan tossed in a few success stories, too. They tell how A.T. Kearney & Co. helped Sears,

Roebuck & Co. save millions, assisting in its search for alternative sources for such products as auto batteries. They also provide a case study of how BCG helped pharmaceutical maker Boehringer Mannheim Group develop a strategy to profitably market an important medical device for diabetics.

There's a useful, though brief, checklist at the end of the book to help clients get the most from their consultants. Among other things, the authors advise managers to set clear goals for hired guns, demand to be served by a consultant's more senior partners, never yield control of an operation to outsiders, and closely measure results, basing payments on performance. Another bit of good advice: Never allow a consulting firm to denigrate your employees. "You are buying intelligence, not arrogance," the authors write.

Still, this is largely a view of the industry from 10,000 feet. Seldom do the authors dive deeply into a firm, its culture, or its people. More often than not, O'Shea and Madigan seem to be scratching their way inside the business from the outside. The consultants you meet in this book are largely faceless, one-dimensional people. So consumed are



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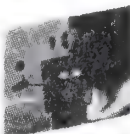
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Books

the authors with a few of consulting well-known foibles that they fail to plain why companies willingly pay a billion a year to advice-givers.

It's not hard to figure out why it occurred. According to the authors' notes, they failed to gain access to many of the industry's key players from Andersen Consulting's George Shaheen to McKinsey co-founder Marvin Bower, the most influential figure in the history of consulting. In fact, they devote scarcely more attention to Bower and his brilliant legacy than to an ex-employee who has filed a sex discrimination suit against McKinsey. Neither did the authors gain any fresh insight into just what kind of advice they got for the nearly half-billion dollars it spent on consultants from 1989 to 1994—even though AT&T is a company whose managers and former executives are known for leaking information to reporters.

Most of all, however, the authors approached the business not with a healthy skepticism of good journalism but with the cynical eyes of gossip columnists. Witness their view of strategy consultants, dubbed the "Dark Vaders of downsizing": "Their intellectual products would make shuttered factories a part of the American landscape and they would create havoc in struggling communities across the land." Yet consultants have helped companies downsize their operations, but in many cases, those cutbacks were critical to survival. And often, the authors' throwaway lines are just as gratuitous. For example, they describe Harvard Business School as "the nation's Ivy League factory for snout-nosed MBAs."

For all their polish and good breeding, some consultants' sales techniques rival those of used-car dealers, and even the best of them can make mistakes. But consultants are a major reason why the U.S. industry is so efficient and productive. Every day, consultants bring sophisticated knowhow and specialized expertise to clients who lack that knowledge in-house. They provide fresh outside perspective to many companies hampered by insular managements. Every botched or useless assignment there are dozens, if not hundreds of others that increase a company's productivity and add black to its bottom line. Few consultants, despite O'Shea and Madigan's scornful view of them, borrow or steal a watch to tell a client the time.

BY JOHN A. BYRNE

Byrne covers management issues
BUSINESS WEEK.

In the World of High-Tech, Change Happens Fast.

Now There Are Two New Ways to Get Up to Speed.

This summer Business Week and CNBC are teaming up to provide a comprehensive and timely look at the phenomenon that is Silicon Valley. In its August 18-August 25 special double issue, Business Week will explore the past, present and future of this vaunted slice of Northern California. Beginning August 4 and running for two weeks, CNBC will pick up where Business Week leaves off, with complementary coverage in segments throughout the day.

Both Business Week and CNBC will talk to the people who put Silicon Valley on the map and examine how the unorthodox business culture born here has increasingly become the model for Corporate America. Other technology hot-spots around the globe, some already well-known, others likely to become household names, will also be featured in these special reports.

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BY STEPHEN H. WILDSTROM

HAVE YOUR MAC—AND WINDOWS, TOO

Virtual PC isn't the first switch-hitter, but it's the simplest and the least expensive

I am writing this column using Microsoft Word 97. What's unusual about that is the fact that I'm working on a Macintosh clone, even though the Mac version of Word 97 is still under construction.

The secret is a clever piece of software called Virtual PC from Connectix (800 950-5880) that allows a Mac to do a surprisingly good job of emulating a Windows PC. In these troubled times for Apple Computer, Virtual PC provides a lifeboat for Mac owners. At a minimum, it offers a way around one of the most serious problems facing the Mac: The ongoing reluctance of software publishers to develop new programs for the system.

EASIEST. Running PC software on a Mac isn't new. Add-in cards from Radius and Apple can put a Windows-ready Pentium processor into a Mac for \$600 or more. And SoftWindows 95, from Insignia Systems, is a \$200 software solution. But Virtual PC, at \$150, is the cheapest, easiest, and most complete answer I've seen.

Virtual PC, which includes a full copy of Windows 95, behaves just like any other Mac application. When you click on its icon, a Win95

desktop pops up in a window or, at your option, fills the entire screen. Just about everything behaves exactly as you would expect with Win95. And you can switch back and forth between the Virtual PC window and any regular Mac application with a mouse click.

You do have to make some allowances for physical differences between the machines. The most notable is that the Mac mouse only has one button, while the PC has two, and Windows 95 uses



This is one way to lessen the risk of sticking with the Mac platform

both heavily. You simulate Windows' right mouse button by pressing a key while clicking. The approach is awkward but familiar to button-deprived Mac users. A better solution would be a mouse with programmable buttons, such as the Kensington Turbo Mouse.

Of course, using a Mac to emulate a Windows PC falls short of the real thing in several ways that can't easily be remedied. The most notable is speed. My blaz-

ingly fast Power Computing Corp.'s PowerCenter Pro with a 210-megahertz PowerPC 604e processor and 64 megabytes of memory imitated a 120 MHz Pentium running Virtual PC. Nonetheless, Microsoft Office 97, a notorious hog of computer power, performed adequately, if a bit sluggishly, under Virtual PC.

HARD PROBLEM. Another difficulty is that while Virtual PC handled all the software I threw at it, most hardware designed for PCs won't work. Accessories such as scanners, tape backups, or Zip storage drives that attach through a printer port are out because the Mac uses a completely different method to connect to printers. You can, however, use Virtual PC with Mac printers. Accessories that connect through a serial port are a mixed bag. The majority of PC modems will work on a Mac with just a change of cable. So will nearly all digital cameras, but scanners, most likely, will fail.

One area where Virtual PC could be improved is the procedure used to read Mac files in Windows. You have to assign a drive letter, such as "G:", to the Mac folder you want to open in Windows. It works fine, but it's cumbersome to set up. (It's a great

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SOFTWARE

PHOTO FIDDLING

At a time when all software looks more and more alike, Kai's Photo Soap from MetaCreations (800 472-9025) certainly stands out. Its unique design (the Windows 95/NT and PowerMac versions appear identical) consists of a series of "rooms" where you perform the various functions the Soap uses to "clean" your digitized photos. I found the



the \$49.95 program made some chores, such as removing red-eye or fixing scratches or speckles in pictures, very easy. But the unfamiliar layout is not as intuitive as I would like. Some tasks, such as changing colors in part of a picture, proved maddeningly difficult.

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BY ROBERT KUTTNER

WHY CONGRESS SHOULD STUB OUT THE TOBACCO DEAL



BAD ODOR:
The parties
met in secret
to settle a
major issue of
public-health
policy—not
quite what the
framers of the
Constitution
had in mind

When tobacco executives, state attorneys general, and public-health advocates announced their 25-year deal on June 20, it seemed an extraordinary coup. The industry gave up a \$368.5 billion pot for victim compensation and antismoking education. It got a cap on liability and a delay in nicotine regulation. Tobacco stocks rallied.

But the settlement is backfiring on the industry, as well it should. Private deals such as this are a bad way to set regulatory policy. The costs of smoking-related illness were \$88 billion in 1995 alone, while the deal covers only about \$8 billion a year, adjusted for inflation, according to recent Senate testimony by Jeffrey E. Harris, a physician and economist at Massachusetts General Hospital and Massachusetts Institute of Technology. Tobacco came to the table only because tort litigation against tobacco was at last making headway. It was the litigation that uncovered the most damaging documents on what the industry knew and what it concealed. Courtroom sympathy is shifting dramatically to plaintiffs. Only last week, a Florida trial judge ruled that the industry's favorite defense—that the public was well aware of the hazards of smoking—could not be used in that state's Medicaid reimbursement suit.

The more headway made by litigation, the less reason antismoking advocates have to settle. After all, the industry exists to sell cigarettes. The more insulated the industry is from litigation and regulation, the more tobacco it will sell. The industry has a long history of turning "constraints" to its advantage. Package warnings, hailed as a public-health advance in the 1960s, became the basis for defeating lawsuits. The ban on TV ads spurred a generation of tobacco-sponsored events and product-placement strategies.

PIPE DREAM. The deal, of course, requires ratification by Congress, since only Congress can delay or hobble the Food & Drug Administration's efforts to gain authority to regulate tobacco as a drug, and only Congress can change the product-liability rules. The industry thought state attorneys general and public-health advocates would troop to Capitol Hill to bless the deal—a pipe dream. The proposal smoked out much tougher opposition by former Republican health appointees C. Everett Koop and David A. Kessler, as well as new demands from mainstream health organizations and the Administration.

The \$5 billion annual cap on claims, combined with a \$1 million ceiling on individual suits, means as few as 5,000 claimants a year could collect. Several arcane provisions would discourage litigation. For example, a special panel of three federal judges would have to approve access to documents that the industry claims are privileged. Litigation would have to pass through the eye of this needle. The deal also bans most class actions.

SACRED TENETS. As the antitobacco side took a closer look at the details, one supporter after another has defected. Apart from its details, the deal was dubious all along on the key grounds of process. The parties got together, in secret negotiations, to settle a major issue of public-health policy. Congress, bystander, was supposed to sign on the dotted line. This was not exactly what the framers of the Constitution had in mind, nor is it the kind of Congress fancies for itself. The deal mod one of the sacred tenets of law and economic theory, which holds that private parties, on their own, will reach efficient bargains. In this case, the absent party was the public, and the deal reached precludes the future use of the common law for future redress.

Second, it is bizarre to design a product-liability cap for one industry. The Supreme Court recently threw out the proposed mass settlement of asbestos claims, on the ground that one group of negotiators could not properly abrogate the rights of those not at the table. And if the tobacco industry, of all industries, gets a cap on product liability, why shouldn't more deserving groups, such as automobile makers or toy manufacturers, get one, too?

Others in the business community are in a quandary. Should they support their tobacco brethren, hoping the pact will set a precedent for similar product-liability agreements? Or should they shun this deal because its obvious failings are giving anticorporate Naderism a boost? Business would be wise to treat the Tobacco deal, well... like a cancer.

This deal is billed as the best trade-off obtainable, but a regulated industry should not be given a veto over the acceptable terms of regulation. Many of the public-health provisions of the deal that step up antismoking campaigns and restrict tobacco marketing are admirable. They should be enacted—and private antitobacco litigation should continue. In a few years, we can revisit a settlement with a deservedly weaker tobacco industry.

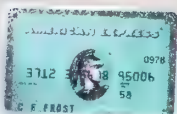
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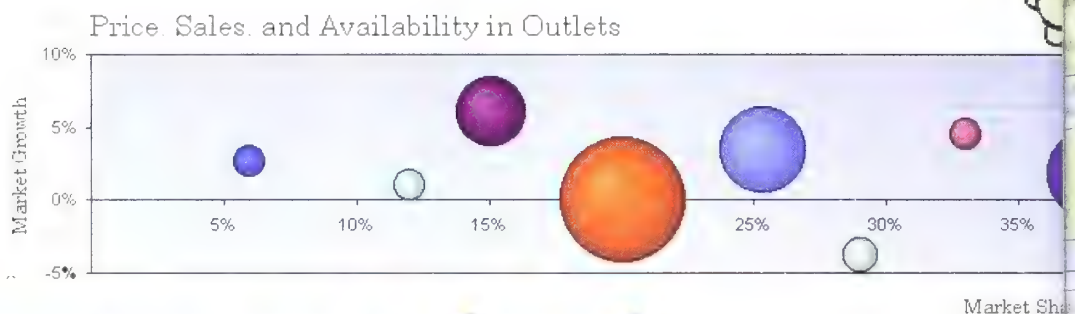
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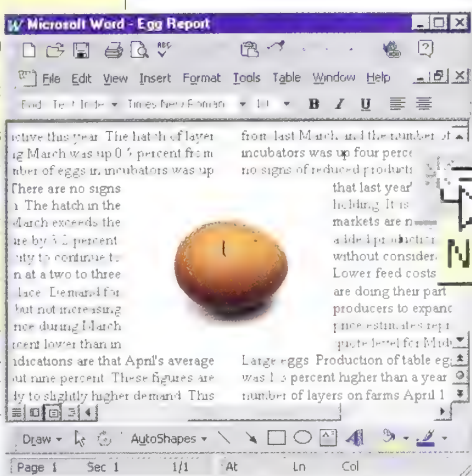
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BY GENE KORETZ

WHERE WEALTH SURGED IN THE '90s

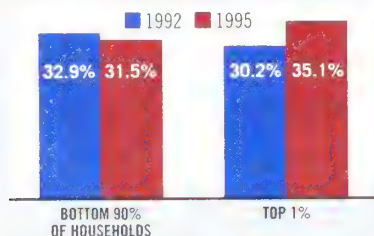
Among a thin slice of households

There's little dispute that incomes have grown more unequal in the U.S. in recent decades. But the question of the distribution of wealth is more controversial. While research by economist Edward N. Wolff of New York University found a sharp increase in the share of wealth held by the top 1% of households in the 1980s, Federal Reserve survey data relying on different statistical adjustments show relatively little change in the concentration of wealth.

The 1990s, however, may be different. A new technical working paper by Arthur B. Kennickell of the Federal Reserve and R. Louise Woodburn of Ernst & Young suggests that the top 1% of the population—especially the top half of that 1%—has been getting a lot richer.

From 1992 to 1995, a period in which household net worth grew by more than

THE RICH GET EVEN RICHER SHARE OF TOTAL U.S. HOUSEHOLD NET WORTH



DATA: ARTHUR B. KENNICHELL, FEDERAL RESERVE BOARD
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\$2.7 trillion, the study finds that the richest 1% boosted their share of the total from 30.2% to 35.1%. What's more, almost all of that gain accrued to the top half of that segment, a group that saw its average net worth jump from \$8 million to \$11.3 million. (The average for the whole top 1% was \$7.2 million.)

Meanwhile, the share held by the bottom 90% of households slipped to just 31.5%, down from 32.9%. Their average net worth: nearly \$73,000—but just \$39,000 when home equity is excluded.

Interestingly enough, the biggest part of the gain racked up by the wealthiest 1% of the population came at the expense of the next 9%. The average net worth of this group remained around \$766,000, but its share of the pie fell by 3.7 percentage points.

What's behind the rising concentration of wealth among the top 1%? A big factor is their growing share of business assets such as private companies, entrepreneurship, and professional corporations, which jumped from 56.5% of the total for all households in 1992 to 71.4% in 1995. And the concentration of stock ownership among the very wealthy means they have reaped huge rewards from the stock market boom, despite the rising number of households investing in mutual funds.

From 1992 to 1995, the value of stocks held by the top 1% surged by a heady 72%. And the group's share of household equity holdings also climbed, from 38.5% to 42.2%, as the share held by the bottom 90% actually fell.

FAST AND LOOSE ON THE MOUND

American League batters beware

Economists call it "moral hazard," and it's a particularly galling problem for insurance companies. It refers to the tendency of persons who are protected from bearing the full costs or negative consequences of particular acts to indulge in such behavior more than they would otherwise do. Those with loss or theft insurance, for example, tend to be more careless about their property than those lacking such security.

But moral hazard occurs in many situations besides insurance. (One often cited example is drivers' tendency to drive more recklessly since seat-belt laws were passed.) In an intriguing study in the current issue of *Economic Inquiry*, Brian L. Goff of Western Kentucky University, William F. Shugart II of the University of Mississippi, and Robert D. Tollison of George Mason University point to a "classic moral hazard problem" created by a rule change in Major League Baseball.

In 1973, the American League introduced the designated-hitter rule, which relieved pitchers of having to come to the plate. The National League never adopted the rule. Since the rule allows American League pitchers to throw at opposing batters with greater impunity than their opposite numbers in the National League (who have to take their turn at bat), the researchers theorized that more American League batters would get hit by pitched balls.

That is exactly what the study shows. From the start of the century through 1972, a batter's chance of getting hit

remained roughly the same in both leagues. But since the designated-hitter rule was introduced, American League batters have been hit by pitches 10% to 15% more than National League batters in a typical season.

Thus, whatever the original intentions of the American League in adopting the designated hitter rule, it has created a clear moral hazard for the game. Freed of worries about having to face personal retaliation from an opposing pitcher, American League pitchers have become far more willing to do it close—or loose—from the mound.



MORAL HAZARD? The designated-hitter rule may affect the throw.

HELP WANTED BY SMALL BUSINESS

Hiring plans surge to record level

To July's strong employment report and other signs that the economy is reaccelerating, add the sentiments of the nation's bellwether small-business sector. According to the National Federation of Independent Business (NFIB), small-business optimism in July hit its highest level since late 1994.

"The picture doesn't get much better than this," says NFIB economist William C. Dunkelberg. Reports of sales increases were the second-highest since 1995, profit gains rose, and 45% of companies said they saw rising sales ahead.

But the biggest news came on the job front. Not only was job creation in both June and July the strongest in years, but hiring plans were reported at 18% of respondents in July, the highest level since the NFIB survey began in 1973. And though the number reporting wage increases was high, it was down from its recent December peak, as plans to raise prices were subdued.

Expectations of future economic growth also notched up their best reading since 1995, and capital-spending plans remained robust. "Based on small business hiring plans," says Dunkelberg, "the unemployment rate should move even lower in August."

JAMES C. COOPER & KATHLEEN MADIGAN

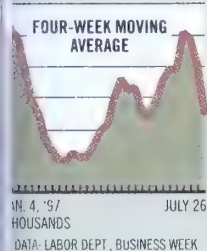
IZZLING STATS AND SWEATY PALMS

Stronger growth, but mediocre productivity, have the markets fretting

U.S. ECONOMY

Wall Street was delighted after Federal Reserve Chairman Alan Greenspan's upbeat assessment of the economy a few weeks ago. He predicted continued moderate growth in the second half and discussed at length the possible inflation benefits of technology-driven gains in productivity. It all sounded like the Fed put policy on hold for a long time, and that was music to the markets' ears.

NEW JOBLESS CLAIMS HEAD BACK DOWN



But a funny thing happened on the way to the second half. Only a day after the Commerce Dept. reported that second-quarter growth had slowed to 2.2% from the first quarter's rapid 4.9% pace, the first broad reports on the third quarter came rolling in. And they were far stronger than expected, suggesting that the second-quarter slowdown was only temporary. Moreover, contrary to expectations, the Commerce Dept.'s revisions to gross domestic product back to 1993 gave no support to the argument that productivity growth in the 1990s is accelerating (page 42).

Wall Street's mood turned sour in a flash, especially in the bond market, as worries about inflation and Fed rate hikes began to resurface. After key reports on July 1 from the Labor Dept. and the nation's purchasing managers, any hopes that the 30-year bond market was headed below 6% anytime soon were dashed. Bonds suffered their worst sell-off in more than a year, pushing the benchmark yield to 6.44%, from 6.29% the week before. The yield has since drifted up to around 6.5%, but good earnings reports have limited the fallout in the stock market (page 158).

ALL STREET'S JITTERS will continue as long as third-quarter data suggest a growth rebound. And so far, the numbers are compelling. The July labor-market report showed that payrolls shot up by 316,000 jobs, more than 80,000 greater than the monthly average in the first half. The unemployment rate fell back to a 24-year low of 4.8% hit in May. Also, new claims for less-than-full-time benefits fell sharply at the end of July (chart), suggesting continued job-market strength in August. At the time, Wall Street was unfazed by those numbers, because wages held steady and hours worked fell.

But the July survey of the nation's purchasing managers was one hot report too many. The composite index of industrial activity, compiled by the National Association of Purchasing Management, surged to 58.6% last month, from 55.7% in June. It hit the highest level since 1994, with all components looking stronger, including new orders (chart).

Particularly worrisome for the markets were the NAPM's inflation-related indexes. Delivery times slowed markedly, after showing no growing strains in the distribution system in the previous four months, and the index of prices paid is drifting up, with the July reading now the highest in more than two years.

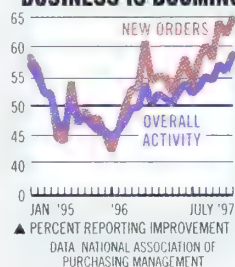
THE MOST CRUCIAL DATA in the rebound forecast, however, are those from consumers, and recent numbers show renewed strength. The second-quarter GDP report said that household spending rose at a paltry 0.8% annual rate, after surging 5.3% in the first quarter, but the monthly data show that spending picked up toward the end of last quarter, after no growth from February through April.

More important, July car sales rebounded strongly, reflecting new incentives and efforts to clear out 1997 models. Sales of domestic and foreign cars and light trucks jumped to a surprisingly sturdy annual rate of 15.4 million, well above the second-quarter average of 14.4 million. And July retail surveys suggest good department store gains.

Another area that promises to provide muscular support to growth in the second half is capital spending. The GDP data revealed that business outlays for buildings and equipment climbed at an annual rate of 15.1%, led by a 20.4% surge in equipment outlays. The surprise is that high-tech equipment was not the main driver. Purchases of more traditional machinery and industrial equipment shot up 23.7%, the largest advance in 3½ years. Companies are responding to strong demand, good profits, and cheap financing. High-tech investment is still rising at a double-digit rate, but it has slowed considerably in recent quarters.

The only possible spoiler in the second-half growth outlook is the first half's rapid pace of inventory

PURCHASERS SAY BUSINESS IS BOOMING



growth. Businesses increased their stockpiles by \$66.8 billion in the second quarter, after adding \$63.7 billion to them in the first quarter (chart). That's the largest two-quarter rise in inventories since 1984. The concern is that second-half production will suffer if companies have to pare excessive stockpiles.

However, the first-half buildup probably has more to do with increasing U.S. demand for imports than with U.S. overproduction. Imports in the first half also rose at the fastest pace since 1984, and excluding oil, foreign goods now account for 30% of U.S. demand for goods. To the extent that any unintended inventory rise is imports, the negative effect of inventory reductions will not fall on U.S. producers.

Moreover, if consumer spending bounces back in the second half, demand will be sufficient to justify further strong inventory growth. In fact, only 10% of the nation's purchasing managers said that July inventory levels were too high, down from 14% in June.

COMBINED WITH PROSPECTS for a strong second half, the failure of the Commerce Dept.'s GDP revisions to show substantially faster economic growth in recent years—and thus a quicker pace of productivity—is stirring up old concerns about how fast the economy can expand without generating inflation. After two major revisions in as many years, the GDP numbers still show that productivity growth in the 1990s is less

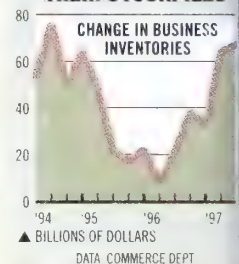
than the productivity growth in the previous decade.

In fact, what the data show is that profits, which were revised up sharply, are taking an ever-rising share of national income, the highest since 1968. Meanwhile, the share of workers' compensation has increased to the lowest proportion since 1968. All this suggests that companies are boosting profits more by squeezing labor costs than by lifting productivity.

But as the strike at United Parcel Service Inc. shows, this strategy has its limits. That strike boils down to a company trying to hold down labor costs with cheaper part-time workers who receive limited benefits, vs. employees who want full-time jobs with more pay and better benefits. For that reason, the markets will be closely watching the strike's outcome (page 40).

One telltale indicator of labor's new feistiness is the July percentage of unemployed people who voluntarily left their last job. It rose to 12.6%, the most since 1991. To the extent that companies had been shaving costs by exploiting job insecurity, that is another sign that further cost containment will be harder to come by in a strong economy with tight labor markets.

COMPANIES BUILD UP THEIR STOCKPILES



JAPAN

TOO HEAVY ON THE BRAKES?

Evidence is growing that Japan's fiscal tightening may be a bigger drag on the economy than initially expected. So while it was widely accepted that second-quarter growth would be very poor, it now appears that the second half will also be weak.

The Apr. 1 hike in the value-added tax to 5% from 3% caused consumers to buy before the hike. As a result, first-quarter real gross domestic product jumped at a 6.6% annual rate, but analysts expect second-quarter GDP to fall by about 3%.

Moreover, last quarter ended with plenty of bad news. While the ratio of job offers to applicants edged up in June, unem-

ployment remained at a record 3.5%. Compared with a year ago: June housing starts fell 11.6%; July vehicle sales were down 10.1%; and household spending posted a startling drop of 4.7%,

the biggest decline in 23 years. All this suggests that the anemic consumer sector, symptomatic of Japan's weak recovery, has not yet turned the corner.

Another big surprise was the unexpectedly large drop in June industrial production—3.1%, the fourth decline

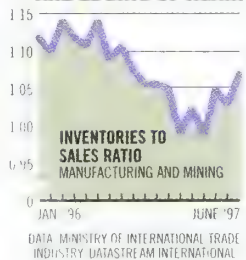
in five months. Weak domestic demand was to blame. Shipments of manufactured goods fell 2%, while inventories rose 1.7% to their highest level in four years. The

inventory-sales ratio is climbing (chart), suggesting little need to boost output anytime soon.

The only bright spot for industry has been exports, which have benefited from the yen's slide vs. the U.S. dollar. But even manufacturers are warning that exports will not continue to increase strongly. For one thing, the yen has strengthened since May. Also many east Asian economies are slowing, so their demand for Japanese goods is waning.

Weak domestic demand means that the economy is more likely to grow at a rate closer to 2% than 3% in the second half. That snarl: Tokyo's plans to cut the budget gap, and pressure may rise to boost growth by weakening the yen. That strategy, while it may lift exports, is sure to exacerbate trade tensions with the U.S.

JAPAN'S INVENTORIES ARE EDGING UP AGAIN



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SMOKE AND MIRRORS?

If the tobacco settlement becomes law, taxpayers could be the big losers

The best place to glimpse the future of the proposed \$368.5 billion tobacco settlement could be Pascagoula, Miss. That's where years of legal battles paid off for tobacco's adversaries on July 15: \$170 million was deposited in Pascagoula's SouthTrust Bank, the first installment in Mississippi's \$3 billion settlement with the industry.

Now the question is: What should Mississippi, the first state to settle with the tobacco industry, do with the money?

FATAL FLAW. The answer will echo around the nation, if Congress adopts the global tobacco settlement reached by 40 state attorneys general and the tobacco industry on June 20. The agreement will likely undergo extensive revision. But using the present settlement as a framework, a growing chorus of critics is starting to follow the money—and they're finding a fatal flaw. Thanks to vague wording in the settlement, much of the money could be misspent, they say, doing little to meet the deal's supposed goals: to improve public health and compensate tobacco victims. Now those critics are worrying that what first looked like a landmark public-health achievement could become a public-policy nightmare.

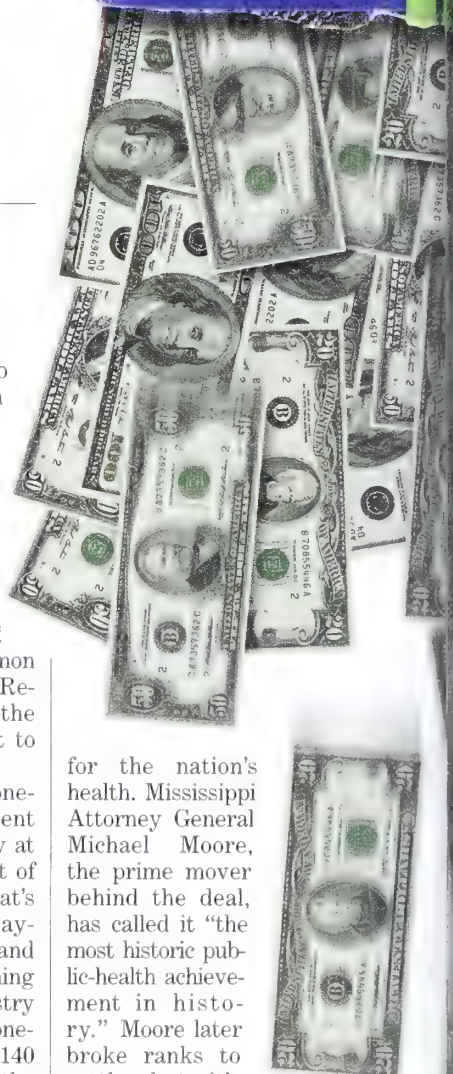
Already, tobacco has quietly won an extremely lucrative prize: In the bal-

anced-budget agreement signed into law on Aug. 5, the companies got a \$50 billion windfall. That's the amount new cigarette taxes will raise, and the budget agreement says tobacco can deduct that amount from what it will owe if the settlement becomes law. That provision followed a 6-month period in which tobacco companies gave nearly \$2 million in unregulated "soft money" to national political parties, according to Common Cause. About \$1.6 million went to Republicans. Philip Morris Cos. led the pack, giving \$794,500—\$673,700 of it to Republicans.

Worse, critics say as much as one-third of the money in the settlement won't come from the tobacco industry at all: Some \$140 billion could come out of the pockets of U.S. taxpayers. That's because the agreement says all payments "shall be deemed ordinary and necessary business expenses"—meaning they are tax deductible. So the industry will get a tax break equal to about one-third of what it pays, or roughly \$140 billion. "This settlement represents the biggest single subsidy of the tobacco industry ever," says Stanton A. Glantz, a professor in the cardiology department at the University of California at San Francisco.

The pact is being sold as a victory

for the nation's health. Mississippi Attorney General Michael Moore, the prime mover behind the deal, has called it "the most historic public-health achievement in history." Moore later broke ranks to settle—but it's not clear he will achieve much for public health. "There are those who say the whole purpose of the suit was to repay the Mississippi taxpayer," says State Senator Dick Hall, chairman of the Mis-



FOLLOW THE MONEY

Tobacco's \$368.5 billion proposed settlement with the states is to be distributed to victims, state coffers, and such things as antismoking campaigns and research, in varying amounts from year to year. But it's not clear the settlement's goals will be met:

\$25 BILLION

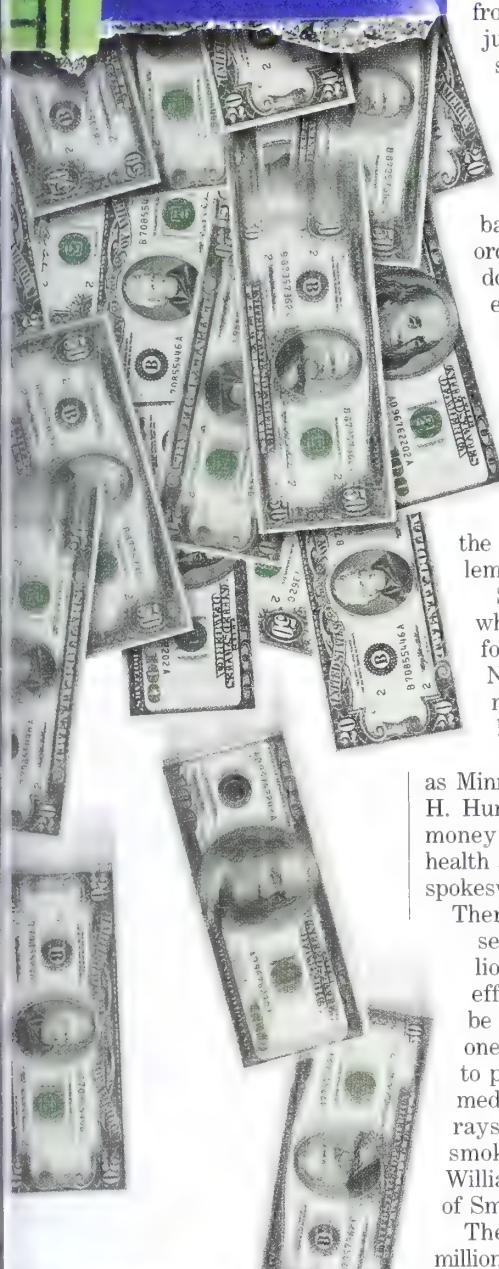
PUBLIC HEALTH TRUST FUND

Decisions about how this will be used for tobacco-related research have not yet been made

\$4 BILLION

A YEAR FOR TOBACCO VICTIMS

Details of how victims will be compensated and what the money can be used for are still unclear



Mississippi Senate appropriations committee.

The issue is so politicized that Hall can't even move the money from Pascagoula to Jackson, the state capital. "The attorney general is from Pascagoula, and the lead attorney, Dickie Scruggs, is from Pascagoula, and I guess they just wanted it down there," he says. When the money reaches Jackson, he fears that "it will be a feeding frenzy." And as Mississippi goes, so may go the nation.

Tobacco isn't winning every battle. On Aug. 6, a Florida court ordered the release of key industry documents. But the industry's losses are few and far between. Even the deal's defenders are concerned tobacco is winning too much. "A lot of issues still haven't been settled. This is all very murky," says William D. Novelli, president of the National Center for Tobacco-Free Kids, who helped negotiate the deal. He believes the deal's problems will ultimately be solved.

State officials even disagree about whether their share should be used for public health. Some, such as New York Attorney General Dennis Vacco, argue that states should be able to use their awards on anything they like. Others, such as Minnesota Attorney General Hubert H. Humphrey III, a critic, believe the money must be "used for the public health and not fixing potholes," says his spokeswoman, Holly Ziemer.

There are other controversies. The settlement allocates about \$1 billion, for example, to antismoking efforts. But the funding may not be effective, critics say. According to one proposal, much of it "would go to pharmaceutical companies and the medical industry" for free chest X-rays and free nicotine patches for smokers who want to quit, says William Godshall, executive director of SmokeFree Pennsylvania.

The agreement provides for \$500 million for an antismoking ad campaign

and additional money for other tobacco-control programs. But Robin Hobart, co-director of Americans for Nonsmokers' Rights in Berkeley, Calif., says it's not enough. "The \$200 million we now spend for tobacco control is just a drop in the bucket."

The ads contemplated in the settlement may also be vulnerable to an industry attack. In Massachusetts, which has an ad program like California's, the industry has lobbied to cut funds for the ads and has even threatened to sue the state for defamation, says Gregory Connolly, who oversees the Massachusetts Tobacco Control Program. "If you think the industry is going to sit back and let opponents run aggressive anti-smoking ads without fighting back, you're crazy."

MAJOR PROBLEM. The settlement does have its defenders, of course. One is attorney John P. Coale, who represents smokers in 26 state class actions. He notes that the deal could overwhelm the U.S. tort system. Tort payouts now total about \$3 billion annually, he says. The settlement could dump \$5 billion into the system—dwarfing all other cases. Coale, a lead negotiator in the agreement, doesn't know how the money will be divvied up. But he's confident it will go to "the things that everyone agrees on... in the end the country gets helped."

But not everyone agrees. A major problem with the agreement is that Congress has control over how much the tobacco industry should pay. And Congress has proved remarkably ineffective at taking any punitive action against the industry. Besides, congressional paralysis was precisely what the agreement was supposed to surmount. That's why the state attorneys general took matters into their own hands. Now that their deal has moved to Congress, tobacco has already won a \$50 billion prize in the congressional halls and cloakrooms it knows so well. That little victory is a warning sign that, settlement or no, the tobacco industry won't fade quietly away.

By Paul Raeburn in New York, with John Carey and Susan Garland in Washington, Amy Barrett in Philadelphia, and Mike France in New York

1 BILLION

**FOR TOBACCO
TION PROGRAMS**
e gobbled up by the
ceutical industry with
imate effect on
g rates

\$600 MILLION

**A YEAR FOR FEDERAL
HEALTH AGENCIES**
Unclear how this money
would be spent and who
would make the actual
spending decisions

\$500 MILLION

**A YEAR FOR
ANTISMOKING ADS**
Far too little to establish
effective programs like those
now operating in California
and Massachusetts

UP TO \$15 BILLION

THE GRAND TOTAL
States would get the balance
of the annual payments and
be free to use the money for
anything from public health
to potholes

AUTO MAKERS



DETROIT FINALLY GETS IT

Ford leads the way in holding down prices. But can carmakers wean the public off the rebate habit?

It had become routine. For years, when Detroit auto makers rolled out their new models each fall, they automatically tacked on a price hike, regardless of what their Japanese competitors were up to. So when Ford Motor Co. announced on Aug. 1 that it would hold prices flat for the new model year, New Jersey auto dealer Peter Jarvis took it as a sign that Detroit had finally got it. "Car manufacturers have woken up and decided they can't go on [raising prices] forever," he says.

It's a wake-up call that many thought the Big Three U.S. carmakers would never answer. But General Motors Corp. announced on June 26 that it would hike 1998 prices just 1.3% on average. And Chrysler Corp. executives hint they will hold prices level, and perhaps even reduce them on a few models. Rigorous cost-cutting and a softer yen have been enabling the Japanese to slice prices on new models as they arrive in the U.S. As a result, in the past three years, Japan's prices inched up just 4%, while the Big Three raised sticker prices by nearly 12%. It's hardly surprising that Tokyo nabbed another 1.5 points of U.S.

car sales from Detroit in that time.

To hang on to sales, domestic auto makers later slapped hefty rebates on all but the hottest vehicles. But Motown is now working the front end, forgoing most increases—and even trimming some prices. At the same time, domestic auto makers are going head-to-head with Japanese rivals in improving quality and adding features. The Big Three still trail Japan in shrinking sticker prices, "but at least they're not still raising prices willy-nilly," says Susan Jacobs, president of Jacobs & Associates, a Rutherford (N.J.) auto consulting firm.

The curbing of car prices cheers economists. Americans' standard of living can rise only if wages outstrip price increases. Big-ticket items such as cars in-

fluence that equation heavily. Rebates already were bringing down the average prices paid for autos, even before the last round of pricing. The Bureau of Labor Statistics calculates that wages rose 3.7% in the 12 months ended June, compared with a mere 0.2% increase in actual car prices. Schroder Wertheim & Co. auto analyst John Cesa says car prices are finally starting to act like those on computers and home appliances: "1998 is shaping up [as] a year when a comparably equipped car costs less than it did in 1997."

SPORT-UTE SCARE. Unfortunately for the Big Three, holding prices in check isn't likely to wean consumers off rebates. "We've taught them if it's not on sale this week, it will be next week," laments dealer Jarvis. So rebates and other incentives, which averaged \$1,700 per vehicle in the first half of 1997, are likely to remain high. One reason: the steep price of a new car, which now averages nearly \$19,000. Says Diane Swonk, deputy chief economist at First Chicago NBD Corp.: "These vehicles won't sell without gimmicks."

Scariest for auto execs is the growing need to offer rebates on high-profit minivans and compact sport-utility vehicles, which until recently were



\$17,990

1998 NISSAN ALTIMA GXE
Down \$1,500



18,795

1998 FORD TAURUS LX

Down \$740



a tear. That's expected to continue as Dodge introduces its big Durango, and on the luxury of sport-utes, Mercedes-Benz brings its Alabama-built M-Class and Lincolns Navigator. In minivans, Toyota or Corp. is offering the Sienna. Its price is more attuned to U.S. than the Previa it replaces. Even full-size pickup trucks, the industry's rebate-free

els were all designed to cost it less, thanks to fewer parts and simpler assembly. Even with GM's modest 1998 price hike, Zarrella says the company has a price edge: "We think we've still got a pretty good value story, vs. the Japanese."

Ford has slashed \$1.8 billion in costs already this year. Flush with profits, the No. 2 auto maker made its watershed announcement: The sticker prices for comparably equipped 1998 cars will fall 1.1%, while truck prices rise 0.5%. Combined, prices will be unchanged.

Ford cut \$740 from the base price of its bread-and-butter Taurus, to

start at \$18,795. And to combat Toyota's RAV4 and Honda Motor Co.'s CR-V small sport-utes, Ford dropped the base price of its two-door, two-wheel-drive Ford Explorer Sport \$1,940, to \$19,995.

In the wake of Ford's actions, the industry is awaiting Chrysler's response. It hasn't yet announced what it will charge for its 1998 lineup, including new midsize sedans, the Chrysler Concorde and Dodge Intrepid, which go on sale this fall. But flat or lower prices are

than the previous version, thanks to a weaker yen and savings on items such as antilock brakes. Some versions of the Honda Accord, set to debut in September, may cost less, too.

Toyota has become the most ambitious cost-cutter of all. It's expected to slash the price of its Corolla subcompact by as much as \$1,000, according to Christopher W. Cedergren, managing partner at Nextrend, a Thousand Oaks (Calif.) auto consulting firm. How? Through myriad small savings on bumper parts, glove compartments, and headlights. And Toyota's Lexus Div. could lop \$6,000 or more from the sticker of its slow-selling GS300 when the new version arrives in October, Cedergren says. "It's going to escalate," he adds. "Toyota is still looking at very aggressive cost-cutting."

FAMILY-SEDAN WAR. The main reason price wars have grown so fierce now is that auto makers continue to add models and boost output, even though car and light-truck sales have been flat at 15 million units for several years. "Demand is not growing, but supply is," says analyst Casesa.

Nowhere is the battle more intense than in family sedans. The new Nissan Altima, Dodge Intrepid, Oldsmobile Intrigue, Mazda 626, Chrysler Concorde, Volkswagen Passat, and volume champ Honda Accord join dozens of current models. Never mind that luxury sales are slack. There will be new Audi A6, Cadillac Seville, and Lexus GS300 sedans, as well as Mercedes CLK and Volvo C70 coupes. The sluggish small-car segment gets a new Toyota Corolla, a Chevy Prizm, and next spring, the '90s version of the VW Beetle.

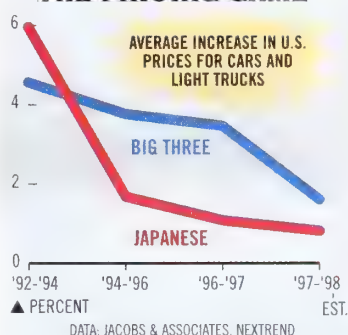
are threatened. marketing chief Ronald L. Zarrella begun to worry about the once-invincible: rebates on big pickups, as sales have slowed lately. "I don't know if it's going to happen," he says. Even if it does, that could get very expensive." Indeed, GM sells nearly 690,000 big pickups each year, so a \$500 rebate would cost the company \$345 million. Detroit's saving grace has been accelerating efficiency and cost-cutting, which give it a way to keep the price on without eating profits. GM's 15 car and truck mod-

a good bet for carryover models. "We've been chasing internal costs very heavily," says James P. Holden,

Chrysler's executive vice-president for sales and marketing. "That, coupled with new products and model simplification, allows us to hold the line."

Despite Detroit's resolve, Japanese carmakers are reducing costs and slashing prices even faster. The most popular version of Nissan Motor Co.'s new Altima costs \$17,990—\$1,500 less

THE PRICING GAME



The glut bodes more headaches for carmakers and dealers but lots of bargains for buyers. "Consumers are in the driver's seat," says Ford Chairman Alex J. Trotman, calling the 1998 model year "the greatest buyer's market in history." For customers frustrated by years of climbing prices, that's good news indeed.

By Kathleen Kerwin in Detroit



UNIONS

THIS PACKAGE IS A HEAVY ONE FOR THE TEAMSTERS

UPS has lots of cash, but the strikers are determined

You can say one thing for Teamsters President Ron Carey: He's got guts. In fact, the strike he called against United Parcel Service Inc. on Aug. 3 is so bold as to seem almost foolhardy.

It's true that the Teamsters drew first blood in the showdown. Almost all of UPS's 185,000 Teamsters have stayed off the job. And UPS is nearly shut down: Its 75,000 managers and nonunion workers are moving less than 5% of the 12 million packages that the Atlanta company typically handles daily, says Chief Executive James P. Kelley.

Still, UPS holds most of the cards. The financially troubled union's strike fund is empty, while the highly profitable UPS, Kelley says, "has enough cash to endure this strike if we have to." And union officers concede privately that it may be difficult to maintain resolve among part-timers, who frequently quit and have little loyalty to UPS or

the union. What's more, Carey is weak politically: He won his post by a whisker and may be forced into a rematch against rival James P. Hoffa because of alleged fund-raising abuses in last December's election (box).

BIG RISK. There's a fair chance that the two sides will settle soon. Indeed, on Aug. 6 they agreed to go back to the bargaining table. Union officials say they came close to a deal in secret talks away from the bargaining table the week before the strike. But Kelley ultimately refused to budge, so Carey walked. That

WHAT'S DIVIDING UPS

PART-TIME WORKERS

UPS has offered to create 1,000 new full-time jobs for the union's 105,000 part-timers and to give 10,000 more part-time workers full-time slots as full-timers retire or quit. The Teamsters want 10,000 new full-time slots now, plus openings from attrition.

PENSIONS

UPS wants to replace the Teamsters' multi-employer pension plan with one just for UPS workers. It would pay full-time drivers \$3,000 a month after 30 years, vs. \$2,000 now. The union wants to keep the Teamsters plan and still lift payments to \$3,000 a month.

NEW YORK WALK

Nearly all 185,000 employees struck union leader Carey's old employer—a company he has longed to take over.

leaves the Teamsters churning a tremendous rivalry since an unsuccessful strike could undermine the union's clout. "UPS clearly has the ability to outlast us," says one Teamsters official, "and what scares me is that they may be willing to take a strike simply because they can afford to."

So why is Carey willing to fight against such odds? The answer stems from 15 years as a militant Teamsters dissident. A UPS driver for 12 years, Carey

headed the Teamsters' largest UPS local for 24 years before becoming president of the Teamsters in 1992. He and other dissidents spent much of the 1980s challenging his predecessors for not taking on UPS, the union's largest employer. Carey took a first shot at UPS when the current pact was signed in 1993. It won better pensions but fell short on other goals, largely because he had prepared members for a showdown.

This time, Carey has spent months bracing the troops for battle. He and other top union officers held hundreds of rallies at UPS facilities around the country. And they showered members with pamphlets and videos explaining key issues. The campaign has succeeded judging by how few workers are crossing the picket lines. "I'm going to stay out as long as it takes," says Benny J. Truesdale, 28, who has worked as a part-time UPS driver in Norcross, Ga., for nine years while he waits for a full-time job.

Truesdale's problem is a key union gripe. Part-timers, who make up 57% of UPS workers, earn half the \$19.95 an hour that full-time drivers make. In 1993, UPS agreed to convert 500 part-time jobs into full-time over four years. UPS has agreed to convert an additional 1,000 jobs and also offered to give part-timers 10,000 full-time jobs that open up from attrition. However,

y believes those jobs will turn full-anyway, since attrition has opened 1,000 full-time jobs since 1993. So he's another 10,000 converted. But sorting more jobs would "cut into flexibility," says Kelley. s did come close to meeting Carey's needs for full-time jobs, say officials, secret talks during the last week of between Dave Murray, the company's chief negotiator, and Ken Hall, his union's counterpart. According to

union officials, Murray also said UPS might drop its demand to pull out of the Teamsters multi-employer pension plan and set one up just for UPS workers. But when Carey and Kelley met on July 30, Kelley went back to the company's original position. Kelley doesn't deny this but says that Murray and Hall "were making a minimal amount of progress."

Since the strike began, Kelley has insisted that Carey let members vote on the contract the union rejected. But

if UPS workers stay solidly behind the union, Kelley may decide that a lengthy strike would be too damaging to morale, even if the company has the financial muscle to win it. If that happens, the two sides likely would pick up where they left off in their secret talks and clinch a deal. And Carey would come out looking like a winner after all.

By Aaron Bernstein in Washington, with Nicole Harris in Atlanta and bureau reports

HOW CLEAN IS MR. CLEAN?

Ron Carey isn't brawling just with United Parcel Service these days. Over the past five years, the Teamsters president has waged a battle to flush corrupt officials from union locals. But now the labor movement's Mr. Clean must defend himself against charges that he reelected campaign last year siphoned union funds. The allegations could well topple Carey, whatever the outcome of his battle with UPS.

Carey was narrowly elected to a second term last December against Detroit lawyer James P. Hoffa, son of former Teamsters head James R. Hoffa. But his story isn't official until the court-appointed election overseer, Wisconsin lawyer Barbara Jack Quindel, says so. Quindel has delayed

her ruling while a Manhattan grand jury probes allegations that union siphoned employer funds wound up in Carey's campaign coffers.

In June, direct-mail consultant Martin Davis was arrested on mail-aud charges for allegedly masterminding a scheme in which Teamsters endorsers overbilled the union for work, then donated the extra payments to Carey's campaign. Federal judges bar using union or corporate money in officers' elections. Davis has pleaded not guilty. A Carey campaign spokesman says Carey had no knowledge of any alleged plan.

But the case has a new twist: The U.S. Attorney for Manhattan is probing whether the Teamsters and the Democratic National Committee skirted election laws in helping each other raise money for their respective campaigns last year. That investigation led to the July 29 resigna-

tion of William W. Hamilton Jr., the Teamsters' top lobbyist. In his letter of resignation, Hamilton says he worked hard to reelect President Clinton and Democrats, as well as Carey, but "in neither effort did I knowingly do anything wrong."

What may be fueling prosecutors' suspicions is an Aug. 11, 1996, memo to Hamilton from fund-raiser Davis, whose company worked for both the Teamsters and the DNC.

In it, Davis informed Hamilton that the DNC wanted campaign checks from the Teamsters totaling \$990,000 made out to 39 state Democratic parties. "I'll let you know when they



RON CAREY'S TEAMSTERS WOES

► A New York grand jury is investigating

allegations that the Teamsters' president made use of union and corporate funds, both of which would be illegal, in his 1996 reelection campaign. The probe so far has implicated Carey's top political consultants, but not Carey himself.

► The same grand jury is now investigating whether the Teamsters and the Democratic National Committee schemed to raise money for each other in violation of federal laws.

► The Senate Governmental Affairs Committee next month may examine ties between the DNC and the Teamsters. The panel on July 31 agreed to subpoena Teamster officials.

have fulfilled their commitments," Davis told Hamilton. Investigators want to know if a quid pro quo existed. Says Cornell University labor expert Michael H. Belzer: "It sounds like the Teamsters got caught up in the cesspool that American politics has become." Spokesmen for the Teamsters and the DNC deny a deal was cut.

TIGHT SPOT. Under Carey, the Teamsters have become major Democratic boosters, giving \$8.5 million to Democratic candidates over the past five years. This means the Justice Dept., which spent \$21 million in taxpayer funds overseeing the latest Teamsters election, is investigating one of President Clinton's biggest financial supporters.

Election officer Quindel is in a tight spot, too. If she nullifies Carey's victory, a new election must be held in which Hoffa could win the presidency. A spokesman says she hopes to rule soon and denies reports that she's stalling until the New York probe is complete. Sources close to the election officer say she is reluctant to rule because there have been campaign violations on both sides. Quindel has ruled that Hoffa's running mate had to return more than \$50,000 in improper donations.

Indeed, Hoffa's campaign may also be under federal scrutiny. The U.S. Attorney in Detroit in June subpoenaed payroll records of pro-Hoffa Local 337. Hoffa spokesman Richard Leebove says he doubts the subpoenas are "related to the Hoffa effort." But a source says the probe may be focusing on whether raises were improperly awarded—and ended up in Hoffa's campaign. Being able to cite the familiar refrain in fund-raising scandals, "They all do it," may not be enough for the embattled Teamsters boss.

By Paula Dwyer in Washington

By Mike McNamee

THE PRODUCTIVITY BOOM IS STILL A MYSTERY

Long before he dreamed of studying economics, Alan Greenspan studied box scores. Growing up in New York, the future Federal Reserve chairman honed his statistical skills on the slugging percentages of the Dodger greats. These days, Greenspan may wish economics was more like baseball. The game has changed—but no one revises 1939's batting averages. In economics, the stats get rewritten every year.

In mid-July, Greenspan went out on a limb. He suggested an upcoming revision of gross domestic product data for 1993-96 would back up his belief that productivity is rising faster than official statistics show. He relied partly on an alternate measure of the economy, gross domestic income, or GDI, which since 1993 has grown much faster than GDP. If the official growth rate were revised to match income growth, the healthy '90s would look even more robust—a clear sign productivity is surging.

FLAWED STATS? Greenspan was not alone on his limb. Weeks before the Fed chief's statement, I predicted in these pages that a large GDP revision would show an acceleration in output sparked by corporate restructuring and technology investment (BW—July 7). And Wall Street seems to accept a new era of growing productivity to support currently high stock valuations.

But the data didn't settle the productivity debate. Statisticians bumped up the GDP's 1993-96 growth rate only slightly—from 2.6% a year to 2.7%. They revised down the income measure a bit but still left a major gap: GDI was \$60 billion higher than GDP in 1996, and it has grown at a substantially stronger 3.9% rate since 1993.

New Economy proponents argue that the next GDP revision will support their thesis. And it's still possi-

ble that the stats are flawed. But "wait 'til next year" isn't going to work. The July 31 figures increase the odds that official economic data will never capture the productivity growth that Greenspan and Wall



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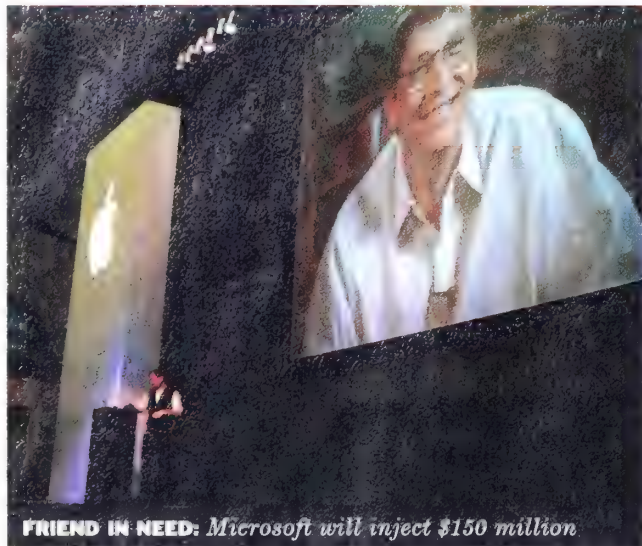
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FRIEND IN NEED: Microsoft will inject \$150 million

MANAGEMENT

IS THIS APPLE'S GRAND PLAN?

Gates's help and a new board may not be enough

Apple Computer Inc. may have long ago lost its magic, but co-founder Steven P. Jobs has surely kept his touch. On Aug. 6, he bounded onto a stage before thousands of partisans at a Boston trade show and stunned the high-tech world with announcements that cast Apple in a brand-new light.

With no official role at Apple other than "adviser," Jobs replaced most of its board with heavy hitters including himself, Oracle Corp. CEO Lawrence J. Ellison, and former IBM CFO Jerome B. York. And in a departure from Apple's solitary fight against the personal-computer masses, he announced a broad pact with archrival Microsoft Corp., which will invest \$150 million in Apple and has pledged to write Mac programs for five years.

BEST CASE. But is there a strategy that can restore Apple's luster? Investors clearly bought into the best-case scenario. Apple shares soared 33% on the day the deal was announced, to \$26.30. But experts say the announcements are tiny first steps toward renewed health. Says analyst Timothy P. Bjarin of Creative Strategies Inc.: "They still really need a three-year strategy and a CEO to implement it."

That's not to say Jobs is sitting still. Fully in charge since former CEO

cross-licensing pact to share patents and Apple's agreement to use Microsoft's Internet Explorer Web browser.

Jobs also produced a top-flight board, including William V. Campbell, a former Apple exec who is now CEO of Intuit Inc., and York, who helped turn around IBM and Chrysler Corp. The new lineup could help recruit the kind of high-powered CEO Apple desperately needs. "This sends a powerful message about Apple," says headhunter David Beirne, who recently turned down an overture from Jobs to find Apple's next chief executive.

But the new chief will face a daunting task. Apple sources say the company is rapidly backing away from its licensing program, on which Mac cloners have built an \$800 million or so industry in the past year. That could scare off customers who don't want to rely solely on Apple machines. And while the Microsoft partnership is far-ranging, the software giant didn't agree to adapt programs like its Office suite to run on Apple's upcoming Rhapsody operating software, the follow-on to Mac OS.

If Apple's future remains hazy, Microsoft is a clear winner. Gates may have been shaken by Mac fans' boos when he appeared during Jobs's keynote address via video link—an outburst that brought a stern lecture from Jobs. But the deal may buy Gates political cover from critics, who claim Microsoft seeks total software domination. It will also help Microsoft lock in millions of Mac users to its Internet software. Then again, Gates's golden touch isn't in question. The issue now is whether Jobs can play Midas to Apple.

By Peter Burrows, with Steve Hamm in San Mateo, Calif., and with Paul Judge in Boston

HMOs

OXFORD'S NEWS ONLY SOUNDS BA

CEO Wiggins quits—but will stick around to run a new u

It has been a spectacular run for Oxford Health Plans Inc. In 13 years under founder Stephen F. Wiggins, the managed-care company has racked up 1.9 million members, nearly 10% annual profit growth, and a \$6.2 billion market capitalization. Wiggins has stake now worth \$240 million.

No wonder Oxford's stock dropped 4%, to 82%, on Aug. 4, even as it reported earnings well above expectations.

The bad news: Wiggins, 41, was giving up the CEO's office at Oxford, staying on only as chairman. President William M. Sullivan, 34, was named chief executive.

SPECIALISTS. Yet investors missed the point. Wiggins will give up day-to-day management responsibilities to focus on a new operation that could have a much bigger payoff for Oxford—and for managed care. He will oversee Oxford Specialty Management, which he says will become "far bigger than the health-plan business."

The new venture addresses the problem of unmanaged specialist care. Today, most specialists receive fees for each service they provide. Under Oxford's plan, teams of specialists will be paid a fixed price to provide comprehensive care for a specific condition. Doctors will retain control over medical decisions—but will be paid more if their patients get well. "It could lower costs and increase productivity. Anything that does that is a good idea," says Kenneth Abramowitz, an analyst at Sanford Bernstein & Co.

Wiggins says Oxford will eventually spin off the unit into a separate company, so it can sell the service to other HMOs. He will stay on at Oxford but also head the new company—and pursue a second fortune.

By Susan Jackson in New Haven



WIGGINS: Vision of a "far bigger" v

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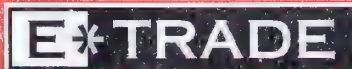
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COMMENTARY

By John Carey

IN THIS DRUG WAR, CONSUMERS ARE THE CASUALTIES

Mention "drug war" and most people think of fighting cocaine or heroin abuse. But there's another big battle under way: Brand-name drugmakers' fight to stop generic copies of their products from hitting the market once their patents expire. With cheaper generic drugs now accounting for more than half of all prescriptions, any brand-name manufacturer that can successfully delay introduction of a new generic rival can reap hundreds of millions of dollars in extra revenue.

Unfortunately for taxpayers and patients, brand-name companies are winning too many of these rearguard actions. And they're employing a host of tactics. The latest audacious move came on July 28, when drugmaker Sero Laboratories Inc. persuaded U.S. District Court Judge Stanley Sporkin to take an unprecedented step: He overturned the Food & Drug Administration's approval of a generic version of Pergonal, a fertility drug.

REVERSAL. Sero originally petitioned the FDA to deny approval to a generic Pergonal back in 1992, arguing that the generic wasn't an exact match, especially when it came to the inactive proteins and other trace ingredients that make up more than 90% of the urine-derived drug. But the FDA didn't buy it. In January, it approved New York-based Ferring Pharmaceuticals Inc.'s application to make a generic version of the drug. Now Sporkin has issued a preliminary injunction barring Ferring from marketing the generic.

Ferring's president and CEO, Dr. Joseph T. Curti, already has filed an appeal. "We think this judgment is very unfair to patients and to the FDA," he says. He's right. For one thing, it's laughable to think judges are better qualified than the FDA to gauge complex scientific issues. For another, experts have found no proof that



HEADACHE: Legal maneuvers could stop companies making generic drugs

generic drugs the FDA has approved differ in any substantive way from brand-name goods. "When people have tried to do studies to show that generics aren't equivalent or that FDA rules are lax, they haven't been able to find any differences," says Leslie Z. Benet, chairman of the biopharmaceutical sciences department at the University of California at San Francisco.

Lawsuits are just one strategy being used by the brand-name companies. Lobbyists for Glaxo Wellcome PLC and G.D. Searle & Co. have wangled longer patent terms through international treaties and amendments to spending bills in Congress. Others have deluged the FDA with arguments that a given generic isn't the same as

the brand-name product. Some have been lobbying states to ban FDA-approved generics. "There's been a tremendous effort by the [brand-name drug] industry to preclude generic competition," says Janet Woodcock, director of the FDA's drug-evaluation center.

One industry tactic, FDA officials say, is the strategy of continuing to make drugs with impurities, inactive substances, and other trace ingredients difficult or impossible to replicate.

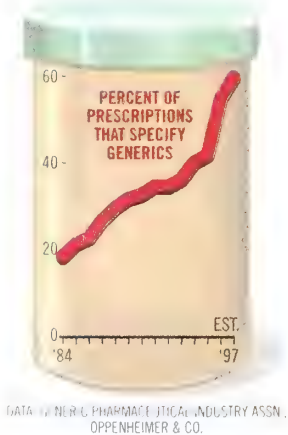
Companies then argue that these poorly understood ingredients may be important to a drug's safety and efficacy. Wyeth-Ayerst Laboratories Inc., for one, used this argument to block a generic version of its \$860 million-a-year estrogen drug Premarin. "One of the most successful strategies to delay competition has been to suggest that we don't know enough to approve a generic," explains Dillon, Read & Co. analyst Jerry I. Treppel.

DuPont Merck Pharmaceutical Co. trotted out a clever scheme last January. When it became clear the FDA would allow Barr Laboratories Inc. to market a generic version of its \$500 million-a-year blood thinner, Coumadin, DuPont Merck financed a drive to get states to pass laws requiring patient and doctor consent for generic substitutions. So far, the effort has paid off only in North Carolina. But CEO Bruce Downey figures Barr is spending \$500,000 monthly to fight back.

Brand-name companies are just protecting their assets. Indeed, as the FDA's Woodcock says, "Their mission is to preserve their market, making whatever arguments they can." But everyone from judges to lawmakers must recognize the drugmakers' arguments for what they are: an effort to protect lucrative products. If they do, this is one drug war that can be won.

Carey covers drug policy from Washington.

A BITTER PILL FOR BRAND-NAME DRUGS



HOME SWEET HOME SALES

ite dip and consumer cash
e mortgage applications

orporate profits are setting records. Unemployment drops to a 24-year low. Even wages are beginning to in upswing.

ere's another statistic to add to the of good economic news: buoyant gage applications. Spurred by a in 30-year mortgage rates, from a year ago to about 7.5% in July, cations from house hunters are at highest level since the Mortgage ers Assn. began keeping tabs in Given the average two-month lag een applications and closings, that ests that the strong housing mar- will continue into the fall, providing ost to the economy as money trick- down to appliance makers, furni- manufacturers, and the like.

ie hot housing industry is a bit of a

surprise. Experts expected the market to cool following record 1996 sales. But after a spring breather, June saw a 6.1% spurt in new-home sales, to 819,000 units. The 4.1 million annual-sales rate of used homes in June was vibrant as well. "We weren't expecting it, but the housing markets are very strong right now—and that's driven by the economy," says David A. Lereah, chief economist at the Mortgage Bankers Assn.

FED HELP. Washington's new tax law could extend the boom into 1998. The measure permits first-time home buyers to take cash out of their retirement plans to use for a downpayment with no penalty. And it expands the exemption from capital-gains taxes on home sales to \$500,000 from the current \$125,000. "We think we will be seeing some churning," says Joel H. Rassman, chief financial officer at Toll Brothers, a homebuilder based in Huntingdon Valley, Penn. "It will free up all this money from people."



BIG BREAK: First-time buyers can use their IRAs

MARKETING

AN AVALANCHE OF NEW IRAs?

kers are talking them up,
new savings may be small

or banks, mutual funds, and stock- brokers, 1998 promises to be the Year of the IRA. After spending a de lobbying for a broad expansion x-advantaged individual retirement nts, Wall Street now hopes to reap benefits.

me investment pros ex- the tax law signed by dent Clinton on Aug. 5 to : annual IRA contributions old to nearly \$50 billion. stment houses are about undate taxpayers with eting designed to sing the es of the new accounts. ill Lynch & Co. has al- y taken out big newspa- ads promoting the new There's certainly a huge, oped market out there: In before participation was ed, 16 million taxpayers ted in the accounts. These , barely 4 million do. t the new law's complexi-

ty will make marketing tough (table). It expands existing accounts and creates two new ones, each with different tax advantages and eligibility rules. "We're challenged on how to cut through the clutter," says Douglas E. Harrison, T. Rowe Price Associates' marketing manager for individual retirement products.

The Roth IRA would let investors avoid taxes on earnings in the account but would not provide tax deductions for contributions that existing IRAs enjoy. That could be a more lucrative benefit for those patient enough to wait. Merrill Vice-Chairman John L. Steffens says marketing themes will center on: "Do you want a tax deduction now or

an even bigger tax deduction in retirement, when you might need it most?"

While funds and discount brokers may have trouble communicating the complexity to their customers, full-service brokers see it as a marketing opportunity. Steffens calls IRAs "a terrific starter product" for attracting young investors.

TAX WINDFALL. Despite brokers' dreams, some experts think IRAs may have a surprisingly small payoff—for Wall Street and the economy. Skeptics warn that much of the money expected to pour into IRAs will merely be shifted from existing taxable accounts. There is some debate over the issue, but that helps explain what happened during 1982-86, when

IRAs were quite popular, but the personal savings rate plummeted from 8% to 4%, where it has stayed.

If such shifting reoccurs, the result will be a tax windfall for savers but little new business for investment firms and a small boost in new savings available for investment.

How much new money will flow into IRAs is anyone's guess. But Wall Street—which lives by the axiom that investments are sold and not bought—is drooling at the opportunity to find out.

By Howard Gleckman in Washington, with Jeffrey M. Laderman in New York

NEXT YEAR'S CHANGES

Wall Street is salivating over an expanded array of individual retirement accounts.

TRADITIONAL IRAs

Tax-deductible contributions will be available to joint filers earning up to \$50,000 in adjusted gross income, up from \$40,000. Penalty-free withdrawals will be allowed for education and first-time home buyers.

ROTH IRAs

In these accounts, earnings can build up tax-free, but there's no deduction for contributions. Available for joint filers earning up to \$150,000 and singles earning \$95,000. Taxpayers making less than \$100,000 can roll traditional IRAs into the accounts.

DATA: JOINT COMMITTEE ON TAXATION

GOVERNMENT

PUTSCH ON THE POTOMAC

Can an ex-Fed governor whip Washington into fiscal shape?

Even for a city that has come to symbolize political chaos, Washington, D.C., had an extraordinary Aug. 5. President Bill Clinton signed a law transferring most local governing authority from Washington's elected mayor and city council to an appointed "control board" headed by former Federal Reserve Board Governor Andrew F. Brimmer.

But when the board tried to meet hours later at a local church, angry demonstrators surrounded Brimmer and his four volunteer board members, shouting: "Free D.C.!" A shoving match with a police SWAT team ensued before the altar—with the diminutive Brimmer standing stoically amid the melee. Then, the board reluctantly set to work naming new city agency administrators.

"SHAMEFUL ACT." Brimmer had better keep his jaw jugged. At the meeting, he promised voters he would move "decisively and swiftly" to fix the city. But there is no guarantee that a board composed of a 70-year-old economist, a college professor, a real estate executive, a retiree, and a museum curator can turn around the nation's 20th-largest city. With a high school dropout rate of 40% and its police cruisers riding on bald tires, D.C. is a monument to urban decay.

Complicating Brimmer's job is the continuing political turmoil in the nation's capital. No sooner had the District's congressional representative, Delegate Eleanor Holmes Norton, brokered



a deal in Congress to provide the District with a four-year, \$1 billion aid package than she reversed herself and denounced the power turnover that was part of the deal as "a shameful act" and "a grave mistake." Mayor Marion Barry Jr. denounced the federal bailout package as "a rape" of the city's limited home rule charter. The city council followed suit.

The control board was created two years ago to review D.C. government budget decisions. Until recently, Brimmer, who declined to speak to BUSINESS WEEK, largely confined his role to oversight of the bloated 30,000-employee municipal payroll. But as the board takes charge of running much of the city, it's likely to attract far more attention—and controversy. "Now, Brimmer has to express a vision for the city that will help refocus a bureaucracy

that's more interested in its own privileges than in serving citizens," says Jamin Raskin, an American University law school dean and District historian.

So far, the control board has been unable to stop the fiscal hemorrhaging. This year's budget shortfall isn't likely to be much better than last year's \$75 million deficit. Meanwhile, the city's population continues to fall and tax revenue

are weak. Worse, the city is barred by federal law from taxing suburban commuters or real estate owned by the federal government, nonprofits, or foreign governments.

The new federal financial package will allow the District to borrow \$300 million from the U.S. Treasury. The federal government also will assume the District's unfunded pension liability of \$4.9 billion and increase its share of Medicaid payments to city residents. It will also pay to have the city's prison system shuttered and the prisoners moved to federal and private facilities.

TAX CREDITS. To stem the flight of the middle class, the IRS will provide \$500 million in federal tax credits for

first-time home buyers and an exemption from capital-gains taxes for investors in businesses in impoverished D.C. areas. "Even with all that, though, the incentives may still not be enough to get people to stay," warns Parry Young, a Standard & Poor's sector who tracks Washington's financial health.

Brimmer's next challenge is finding a manager for the day-to-day operation of the city government. If he can find someone with enough political savvy, he could stay in the background doing what he does best. Otherwise, he will have to get used to shoving matches and irritating protesters.

By Paul Magnusson in Washington

OFFICERS!

Brimmer calls for police to cool off protesters who shouted "Free D.C.!"

CAPITAL IDEAS

Andrew Brimmer and his team aim to remake Washington's government.

HIRE overall city manager and management-consultant teams for nine additional city agencies now under authority of the D.C. control board.

REPLACE OR REAPPOINT all agency directors, including those for public works, fire and emergency medical services, welfare, public health, and housing.

REFORM the city's contracting, personnel, asset management, and information-technology programs and hire private companies to aid in city tax collection.

REPAIR city school buildings, consolidate school districts, close underused schools, and make principals accountable for teacher and student performance.

HELP CLOSE the city's 5,000-inmate prison in suburban Virginia. Prisoners would be transferred to federal prisons and private correctional facilities.

DATA BUSINESS WEEK

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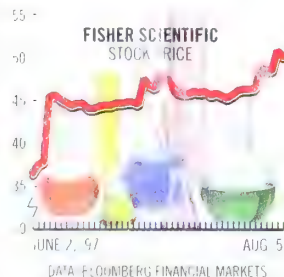
HILTON PLAYS LIKE A HIGH ROLLER

STEPHEN BOLLENBACH WANTS more casinos—badly. In a surprise move, the Hilton Hotels chief executive has upped his hostile offer for ITT to a heady \$70 a share—or \$8.3 billion. Earlier this year, ITT rebuffed Bollenbach's \$6.5 billion offer for the company and embarked on a series of defensive moves, including a \$2 billion debt and stock buy-back program. Most recently, ITT announced plans to split in three, and many analysts thought that would finally put an end to Hilton's bid. But now Bollenbach is making clear he's still gunning for ITT's prized Caesar's World casinos so he can add them to Hilton's own casino

CLOSING BELL

FIXING FISHER

Fisher Scientific is on the operating table, but it's unclear who might heal the medical-equipment company. Shares have jumped more than 2, to 50%, since Aug. 1 on speculation that buyout behemoth Kohlberg Kravis Roberts would bid for the company. That caps a long run for Fisher's stock: In June, it surged nearly 25% following an unsolicited offer of \$48 a share by a Bass family fund. KKR, Bass, and Fisher won't comment, but analysts say the firm could sew up a deal without sweetening the bid.



holdings. Is \$70 a share too high? Not for Bollenbach, who has wasted little time energizing the once sleepily run Hilton chain since taking charge 18 months ago.

MGM: WE'RE OFF TO SEE THE BANKER

LIGHTS, CAMERA, OFFERING: Hoping to capitalize on the hot stock market and the buzz surrounding its expected December release of *Tomorrow Never Dies*, a James Bond thriller, Metro-Goldwyn-Mayer said on Aug. 5 that it would launch an initial public offering for 12% of the company "as soon as possible." The studio, one of the only pure plays in movie production, hopes that it can raise about \$250 million. A group led by financier Kirk Kerkorian that bought MGM last year for \$1.3 billion from French bank Crédit Lyonnais.

PAGING NETWORK FACES SOME STATIC

NOW HEAR THIS: TROUBLED by poor acceptance of its new voice pagers, Paging Network's chairman and chief executive both resigned Aug. 5. They were replaced by board member and former Sprint President John Frazee. In July, Paging Network officials said they would soon halt expansion of Voice Now, a \$10-a-month pager service that sends and plays voice messages on a handheld pager. Costs of that service helped push second-quarter losses to \$50.4 million, up from \$18.5 million a year earlier.

A MIRACLE WORKER FOR COLUMBIA/HCA?

JUST WHAT THE DOCTOR ordered? Trying to heal a stricken Columbia/HCA Healthcare, CEO Thomas Frist Jr. on

HEADLINER: ROSEMARIE GRECO

CORESTATES LOSES A KEY ASSET

Rosemarie Greco traveled a long way from the convent she left in 1968 to the No. 2 spot at CoreStates Financial. But on Aug. 4, the president of the Philadelphia bank startled Wall Street by announcing she was resigning for "personal reasons."

Greco, also a former teacher, had been named president of \$47 billion CoreStates, the 21st-largest bank, just over a year ago by CEO Terrence Larsen. She began in banking as a secretary at Fidelity Bank in 1968, moving up the ranks to join CoreStates in 1991.

As president of Core-

States' holding company, Greco was one of the highest-ranking women in banking. She helped Larsen manage a flurry of successful acquisitions, but CoreStates has been criticized for the less-than-stellar performance of its latest, Meridian Bancorp.

Greco declined comment. But analysts say her departure leaves a void in CoreStates management and increases the odds it will be sold or merged. Bank executives were already in the midst of a strategic review of CoreStates' direction when Greco's departure was announced.

By Amy Barre



Aug. 4 named Jack Bovender Jr., a fellow HCA alumnus, president and chief operating officer. Bovender, 51, will have his hands full, with Columbia the subject of a massive federal investigation for possible Medicare and Medicaid fraud. Three Columbia executives were indicted in Florida on July 30. On Aug. 5, Florida said it would also look into Columbia. But the new president is already working to clean up the company. He and Frist have ended controversial arrangements that give doctors financial stakes in its hospitals. Says Bovender: "It's a new regime with old-school values."

A BAD SIDE EFFECT MARS AETNA'S CURE

IT MAY BE A TRANSFORMED company, but Aetna Life & Casualty still hasn't convinced investors that it has found a winning formula. The stock

of the venerable insurer, which merged with US Healthcare in 1996 to become more of a national HMO, fell 14%, to 102%, on Aug. 4 after reporting disappointing second-quarter results in the medical business. Income of \$230 million on revenues of \$4.63 billion was in line with analysts' estimates. But costs were higher than expected, and executives warned that Aetna was trimming its forecasts for adding new members to its health-care plan.

ET CETERA...

- General Motors unveiled a \$2.5 billion share-repurchase program.
- Cabletron is replacing Robert Levine with Nynex's Dan Reed.
- PG&E is buying 19 New England Electric System plants for \$1.6 billion.
- Clinton named Colin Powell's son, Michael, to a seat on the FCC.

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High Yield Bond Funds

Spartan® High-Income Fund ^{7,8}	5★	5★	5★	N/A
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ED BY OWEN ULLMANN

HERE IS CLINTON HEADED? WATCH HIS CHOICE FOR STAFF CHIEF

The balanced-budget bill signed into law by Bill Clinton on Aug. 5 may win the President a place in history. For Chief of Staff Erskine B. Bowles, it's a ticket home to South Carolina. A venture capitalist who's never warmed to political risk-taking, Bowles vowed to stay on the job just long enough to tame the deficit.

Now, with Bowles widely expected to depart before year's end, White House colleagues and lawmakers on Capitol Hill are speculating about a replacement. The favorites: Treasury Secretary Robert E. Rubin, Office of Management & Budget Director Franklin D. Roosevelt Jr., National Security Adviser Samuel R. Dineen, Deputy Chief of Staff John D. Podesta, and chief congressional lobbyist John L. Hilley. In choosing a new staff chief, the President is sending an important signal about his plans for the next three years. Will he seek a clone who can work with a GOP Congress to cut deals? Does he want a visionary who can mold a Clinton legacy? Will he shift focus—like most second-term Presidents—from domestic to foreign policy? Or will he play it safe with a supermanager who keeps Clinton on schedule and minimizes scandal fallout?

FOCUS? Although the job is high-profile, it may require a Clinton charm offensive to lure the one that lured Bowles. Rubin rebuffed Clinton feeler about taking the post in 1996, and still tops the President's list. The former Wall Street is one of Clinton's closest advisers and "he knows the White House staff better than anybody else," says one insider. Clintonites think Rubin might be persuaded to take the job if he's allowed to focus on trade and other international economic initiatives. But Rubin's selection wouldn't augur for compromise with Congress on issues such as tax reform. Republicans, who admire Bowles as a fiscal conservative can trust, grouse that the Treasury chief is too partisan.

The GOP would be much happier if Clinton tapped Raines. Hill leaders credit him for playing a major role in crafting the budget deal. And White House colleagues say the former Fannie Mae vice-chairman is a strong manager skilled at forging compromises. As staff chief, Raines, an advocate of entitlement reform, would be expected to make overhauling Medicare and Social Security a top priority. For now, though, Raines insists he doesn't want the job.

If Rubin and Raines are true to their word, Clinton may turn to National Security Adviser Berger, a longtime friend and adviser. With Berger at his side, Clinton would spend more time on the international stage pressing for Mideast breakthroughs and maybe a rapprochement with Iran. Bowles's deputy, Podesta, is an organizational whiz and veteran troubleshooter in charge of Whitewater and Donorgate damage control. His elevation would mean that Clinton is opting to stay the course while mounting an aggressive counterattack against ethics allegations. Hilley, a former Hill staffer respected on both sides of the aisle, could help the President forge legislative compromises. "Clinton needs somebody who can wire him with Congress," says former adviser Dick Morris. "Hilley is trusted."

If the President looks outside the Administration, one candidate is former White House counsel Jack Quinn, once chief of staff to Vice-President Al Gore, who will be playing a more prominent role in the White House as 2000 approaches. Hill Democrats are pushing California Representative Vic Fazio, a partisan warrior like Bowles's predecessor, Leon E. Panetta.

Bowles ended the warfare and forged bipartisan trust in Washington. Now, Clinton has to decide whether to build on that legacy or return to the days of political confrontation.

By Richard S. Dunham



JOB DONE: Bowles wants out

CAPITAL WRAPUP

THE NEW FACE OF THE GOP?

Republican National Committee chairman Jim Nicholson wins raves from party insiders as a strong fundraiser and manager, but some GOPers think he lacks the charisma of his folksy predecessor, Haley Barbour. Their reaction: a telegenic spokesperson for the RNC. One name being kicked around is Representative Bill Paxon of New York, who was deposed from House Republican leadership in July following the failed coup against House Speaker Newt Gingrich (R-Ga.).

Newtoids fear Paxon's selection would be a slap at Gingrich and embolden the upstate New York lawmaker to challenge Gingrich for the Speakership.

To dampen anti-Newt sentiment in the House, some senior Republicans are talking about ending this year's session of Congress as early as Oct. 24. GOP strategists say an early adjournment will give lawmakers more time to bond with constituents and less time to stir up another rebellion. One proponent dubs the idea the "Speaker Protection Plan."

SO YOU WANTED A TAX CUT

► It was well known that the 1997 tax act would complicate the Internal Revenue Code. But Commerce Clearing House, a publisher of tax news, tells just how badly. It figures the law creates 285 new sections of the code and amends 824 others. Some 36 provisions are changed retroactively, and 114 others took effect on Aug. 5—the day the bill was signed. An additional 69 will take place in 1998 and 5 in 1999 and beyond. Congress explains it all in just 225,000 words.

CHINA

OVERHAULING CHINA INC.?

Beijing's new catchword: Privatization

First came President Jiang Zemin's call in May for greater privatization of the Chinese economy at a speech to ranking cadres at the Central Party School. Then, economic czar Zhu Rongji, who many expect to become the next premier, used his widely publicized 12-day tour across China's northern Rust Belt in July to lecture ailing state enterprises on the need to shape up.

It has all the markings of a political crusade. Much the way the late Deng Xiaoping got the capitalist bandwagon rolling with his 1992 sweep through

ranging from cars to consumer appliances. Thousands of government-owned factories are to be sold or pushed into bankruptcy. Instead, Beijing will focus on nurturing some 1,000 conglomerates, not unlike the business groups of Japan and South Korea, to lead China into the 21st century.

NEXT LEVEL. Combined with other reforms, such as national pension and health-care systems that will relieve the heavy social-welfare burdens of employers, the goal is not only to keep the state sector from financial collapse. It also is aimed at pushing China's economy

to the next level, producing industrial conglomerates big and efficient enough to compete globally. Says Denis Simon, director of Andersen Consulting's China Strategy Group: "China needs to recast its entire industrial architecture."

Such reforms could bring wrenching pain in a country where urban unemployment already is near 15%. But the timing has rarely been better. After four years of tight-money policies, Zhu

seems to have engineered a remarkably soft landing for the once overheated economy. In this year's first six months, the economy grew 9.5%. Retail inflation is just 1.8%, after hitting 24% in 1994. China is posting big trade surpluses, and foreign reserves top \$121 billion. This comes at a time when neighbors such as Thailand, South Korea, and Malaysia have been hit by plunging currencies and flat export growth.



South China, the Communist Party hierarchy has been out on the hustings to rally consensus for a new wave of bold economic reforms. The initiatives are now being debated between swims and seafood banquets at the leadership's annual retreat at China's coastal resort of Beidaihe. They are likely to be unveiled at this fall's Party Congress, the confab conducted every five years to chart the country's future course.

The agenda is expected to be far-reaching. A key feature: promoting a wave of mergers meant to consolidate unwieldy, massively overbuilt industries

POINT MAN

Vice-Premier Zhu hopes the new reforms will pave his way to the premiership



China's leadership is now free to concentrate on the economy. Two major tests of stability this year—the death of Deng and the July handover of Hong Kong—have passed without incident. In his quest to assume Deng's mantle, Jiang would like to be known as the leader who turned China into a modern industrial power. And Zhu would like to burnish his claim to the premiership when conservative Li Peng



BLOATED

Many state companies are money losers, yet they suck up most of the credit

up 75% of domestic credit. Thus, the banking system is a nightmare: At least 20% of loans are nonperforming.

Beijing will have to proceed gingerly to avoid a social backlash. Jiang is taking "a no-pain, no-gain approach to the economy," says one Western diplomat. "That's not a very popular position." Already, there are reports of rising worker unrest. In July, hundreds of people hit the streets to protest a textile factory closure in Sichuan Province. The nervous provincial government agreed to pay workers until they find new jobs. That doesn't bode well for Beijing. According to official estimates, 15 million workers—12.5% of the workforce at state enterprises—will have to be laid off in the coming years.

Chinese leaders know they can't procrastinate. Indeed, many authorities at the local level aren't waiting for Beijing to settle on a game plan. Take housing reform. To spur the movement toward private ownership, authorities in the eastern city of Nanjing banned local enterprises from renting new apartments to their employees. Instead, they must sell them to workers.

MORE MERGERS. Local governments are tackling another major problem: enormous overcapacity because too many factories make similar goods. In Shanghai, the city has already idled 230,000 workers in its effort to consolidate its bloated textile sector. So far, the city has sent 150,000 of these workers to training centers to study computers, accounting, and other new skills.

Shanghai also is at the forefront of mergers. The city recently established the Yangtze River Region Asset & Equity Exchange, a bourse for buying and selling holdings of state enterprises in 11 provinces. Among the first deals brokered by the exchange was the sale of a bankrupt rubber plant in Chongqing for \$12 million to the Shanghai Huayi (Group) Co., a diversified industrial conglomerate. "There are more transre-

gional mergers than ever," says the exchange's president, Zhang Hailong, who expects the bourse to handle \$2.4 billion worth of deals this year.

But that is only a small start given what needs to be done. Numerous industries are overcrowded with rivals, few of them big enough to compete efficiently. China has 123 car and truck plants, for example, that made just 1.47 million units last year—less than one-sixth the output of Detroit's Big Three. Yet at last count, 22 Chinese municipal, provincial, and regional governments still are targeting auto manufacturing. There are 189 motorcycle factories, and so many televisions were being churned out that Beijing has banned new plants.

To spur consolidation, Beijing has earmarked \$3.7 billion to ease the pain of mergers and bankruptcies. It also plans to modernize its stock and bond markets so that companies can depend less on banks for financing. What's more, Jiang has said that state enterprises should have a much broader ownership base and that government ownership of less than 51% of shares is acceptable.

For China, which still officially clings

THE GAME PLAN

- Concentrate on turning the top 1,000 state companies into strong conglomerates, allowing many of the remaining 117,000 to be sold or closed
- Greatly reduce the number of redundant factories making cars, beer, appliances, and other goods by encouraging mergers and discouraging new entrants
- Release state companies from the burden of providing health care, pensions, and housing by setting up national health and retirement schemes and making it easier for workers to buy homes
- Broaden government programs to retrain an estimated 15 million factory workers who will lose their jobs through consolidation

DATA: WORLD BANK, BUSINESS WEEK

to Marxism as a guiding principle, the implications of Jiang's message are huge. Predicts Goldman Sachs (Asia) Executive Director Shan Li: "The 15th Party Congress will be the Congress of privatization." If so, China's communist leaders will have crossed an ideological threshold even Deng dared not breach.

By Dexter Roberts in Beijing, with Mark L. Clifford in Hong Kong and Matt Miller in Shanghai

next spring. Besides, many city provincial governments are already riding on the reform bandwagon as they try to salvage their industries. That's not to say the leadership isn't facing a daunting challenge. For starters, it's the magnitude of the problem. According to a June World Bank report, about half of China's 118,000 state enterprises lost money in 1996, up from third two years ago. Still, they suck

COMMENTARY

By Brian Bremner

SOUTH KOREA NEEDS A FEW GOOD BANKRUPTCIES

A reckoning of sorts is under way in Seoul. Years of relentless and debt-fueled corporate expansion have culminated in the failure of five major South Korean industrial groups, or *chaebol*, since January. It has been a jolt to Koreans who thought the *chaebol* were too big and too politically plugged in to ever go under.

Of course, the crisis could also be an opportunity. Allowing the weakest of the overbuilt steel and auto makers to go bankrupt would mean the healthy shakeout of an economy that's leveraged to the hilt.

It's a pity that probably won't happen soon. Already, there are signs that Korean President Kim Young Sam's government intends to reshuffle assets among existing *chaebol* rather than let some fail outright. The government's plan for a mix of handouts and stage-managed mergers won't add up to the overhaul of the *chaebol*-dominated economy the country so desperately needs.

DOWNGRADE? Such preferential treatment mattered less when Korea was growing at double-digit rates. But it matters greatly now that this \$485 billion economy is losing its export competitiveness and growth has slowed to near 5%. The country lacks a vibrant small-business sector to generate jobs, and it has borrowed heavily in off shore capital markets. Korea's private foreign-debt exposure is about \$100 billion, or 20% of gross domestic product. A lot of that is short-term financing that could bolt at the first whiff of more trouble. That's why, on Aug. 4, credit-rating agency Moody's Investors Service placed South Korean debt on review for a possible downgrade.

All this cries out for some serious political leadership. Yet so far, Kim's government seems more interested in preserving the status quo in order to ensure the success of his ruling

New Korea Party in a general election set for December. Consider the recent moves by state-owned Pohang Iron & Steel Co. It snapped up a big chunk of bankrupt Sammi Steel Co. earlier this year and last month made a \$2.25 billion bid with Dongkuk Steel Mill Co. for part of the steelworks of another failed *chaebol*, the Hanbo Group. The bid

lition Kia Group. The ailing auto-and-steel concern, with \$10.7 billion in debt, became insolvent in mid-July. Its two auto affiliates, Kia Motors Corp. and Asia Motors Co., and their supplier networks account for 1.5% of the nation's economic output.

CAR GLUT. Analysts think Samsung Group, which won government approval to enter the overcrowded auto industry next year, is angling for Kia, though Samsung isn't talking.

Maybe Samsung or rival car-makers Hyundai Corp. and Daewoo Corp. could revive

Kia. But does Korea really need a half-dozen major carmakers planning to manufacture an excess supply of 3.45 million vehicles by 2001?

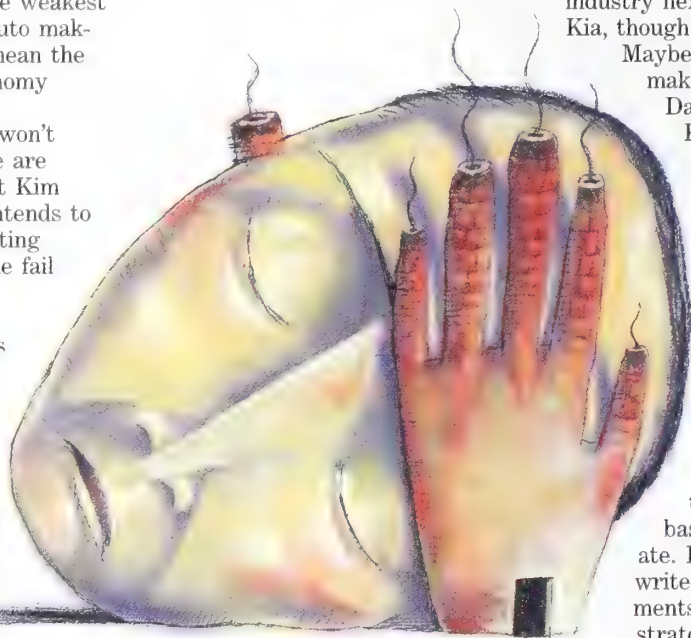
To its credit, Kim's government has taken tentative steps to cut *chaebol* debt levels.

The Finance & Economy Ministry has set new guidelines that ban banks from lending more than 45% of their capital base to any one conglomerate. It has also limited tax write-offs on interest payments by companies with stratospheric debt loads. But that's just a modest start.

The truth is, Korea has too much capacity in virtually every sector. And that means some businesses need to fail. It also means that rock-solid job security and wage gains that have outpaced productivity

gains for the better part of a decade can no longer be guaranteed either. If the *chaebol* don't clean up their balance sheets, refocus on core strengths, and dump money-losing businesses, their problems will only compound. It won't be a joyride for Kim or the *chaebol*. But the alternative is to let things get so bad that foreign lenders call in their loans and currency speculators hammer the won. Just ask the Thais.

Bremner is BUSINESS WEEK's Tokyo bureau chief.



Almost every sector has too much capacity. Letting the weakest *chaebol* go under would be healthy

was rejected by Hanbo's creditors. Even so, investors have been dumping Pohang shares, fearing the government will strong-arm the company into putting Hanbo employees on its payroll, adding unneeded capacity. True, the move would soften the economic pain. But it certainly doesn't make much economic sense given the global glut in steel production.

On another front, the Federation of Korean Industries, as well as ordinary Koreans who have launched a public support campaign, want the government to prop up the \$20 bil-



KOHL: *The deadlock over reform has left business leaders furious*

exchange-rate risk if they relocate to, say, Spain or Portugal.

Economists had predicted that tax reform would offset the relocation trend, adding as much as a percentage point to gross domestic product growth in 1999. No more. "This is a disaster for the German economy," says Bank Julius Baer economist Gerhard Grebe. He predicts GDP growth will top out at 2.7% next year and drop again in 1999 to 2.5%. Such growth rates aren't nearly enough to make a dent in joblessness.

LOOKING FOR HAVENS. Fears of an interest-rate hike are adding to the negative vibes. The mark has plunged 21% this year, to about 1.88 per dollar. If it keeps dropping, many analysts believe that inflation worries will force the Bundesbank to phase in higher short-term bank rates. Most analysts figure the central bank will do all it can to avoid raising rates, but "the odds are going up" that it will have to act, says Kermit Schoenholtz, London-based global chief economist for Salomon Brothers Inc.

No wonder capital is going on strike against Germany. Last year, foreign companies repatriated all their German profits—a net \$2.6 billion. That's the first outflow in years. Domestic companies aren't spending as expected, either. And some are taking radical action. Geers Hörakustik, a 470-employee German hearing-aid company, may move its purchasing operations to a tax haven abroad. Says CEO Volker Geers: "It's clear now that costs [in Germany] are only going to rise."

Ironically, Germany's stock index keeps reaching new highs. While Bonn dithers, corporate chieftains have shouldered the burden of trimming costs and focusing on shareholder value. As a result, the DAX is up 49% year-to-date. But since companies are boosting profits largely by exporting employees and capital, the stock euphoria doesn't reflect the economic climate. Without reform, more German companies will keep trying to flee high taxes and wages. Stock boom or no, that means the German economy will only get hollower.

By Thane Peterson, Karen Lowry Miller, and David Woodruff in Frankfurt

IMANY

FIASCO FOR GERMANY

Kohl's tax reform stalls, CEOs send jobs and capital abroad

Just when it seemed things couldn't get much worse for Germany, they did. Despite forecasts of accelerating economic growth, the country's woes—rising unemployment, a plummeting currency, and government paralysis—cast a pall over the summer holidays. Then, in late July, the Bundesbank signaled it might raise interest rates for the first time since 1992. And a fiscal showdown snuffed out Chancellor Helmut Kohl's tax reform package, which business badly needed.

In a country that has waited six years for its economy to regain vitality, malaise may be reaching a crisis point. It's not just the 4.4 million jobless who feel the system has let them down. The upper echelons of business and government are growing more negative the day on Germany's "consensus capitalism." And politicians have so far hesitated to risk decisive action. Indeed, the impasse over taxes has sent a warning signal that other needed economic reforms will stay on the back burner until after parliamentary elections in September, 1998.

Business executives are furious at Bonn. "We

need the politicians to give us a reasonable framework and the freedom to [compete]," says Manfred Schneider, CEO of chemical giant Bayer Group. Adds Peer Schatz, chief financial officer of biotech company Qiagen: "Just when we need leadership, we have a government that can't get anything done. It's very disillusioning." A BMW exec calls reform's failure "a fiasco for Germany."

Corporate ire will drive Germany into worse trouble. So far, the recovery has been propelled by exports, made more competitive on world markets by the weak mark. With unemployment stuck around 11%, consumer demand has been sluggish. As exports lifted profits, the government had hoped companies would start expanding domestic factories and adding personnel later this year.

Instead, disgusted CEOs are likely to keep sending jobs and capital abroad, where wages and taxes are lower. The outflow of direct investment from Germany hit \$25 billion in 1996, double the 1993 level. That stream could turn into a torrent if Europe, as planned, shifts to a single currency in 1999, because German companies will no longer face any

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TAX REFORM

The Kohl government's inability to push through a tax reform package could depress capital investment and economic recovery.

CURRENCY WOES

The mark is off substantially this year against the dollar and the pound. That's boosting exports—but also fueling inflation fears.

RATE JITTERS

To bolster the mark, the Bundesbank has signaled that it may hike interest rates—another blow to business confidence.

GRIDLOCK

The government is likely to put off badly needed labor, health-care, and pension reforms until after parliamentary elections in September, 1998.



BARLEY HARVEST: Farmland buyers see a rich market for foodstuffs in Asia

ARGENTINA

A STAMPEDE ON THE PAMPAS

George Soros leads a horde of investors buying Argentine land

The Argentine pampas possess some of the world's most fertile farmland. In the first quarter of this century, commodities such as beef and wheat made the country one of the world's 10 richest. But by the 1930s, exorbitant export taxes, inadequate infrastructure, and economic and political instability had scared away most investors.

Not anymore. Led by U.S. financier George Soros, deep-pocketed investors are returning to the Argentine heartland, where land sales have quadrupled since 1991, according to Madero Lanusse Belaustegui, a real estate company in Buenos Aires. Encouraged by rising world commodity prices, the buyers believe Argentina will help fill Asia's fast-growing demand for foodstuffs. Lower inflation, reduced taxes on exports, and improved roads and telecommunications are once again making farming a lucrative business.

As agricultural subsidies and trade barriers fall worldwide, Argentina's annual farm output is expected to rise from 52.8 million tons now to 80 million by 2000. "The competitiveness of Argentine land is the best in the world for price and yield," says Bruno Barbier, the Belgian president of Agro-Invest, which manages a \$20 million fund in-

vesting in Argentine land acquisitions. Says Eduardo Elstain, Soros' partner in Argentina: "The sector is experiencing a dynamism it hasn't had for years."

Soros' purchases of farmland and commercial real estate have unleashed a wave of interest in Argentine properties. For the Hungarian-born philanthropist (page 148), who is one of the country's largest landowners, it's a long-term commodity play. Soros is betting prices of grain and beef will rise while agricultural subsidies decrease, says ING Barings analyst Tadd Chessen. With a 27% stake, Soros' Quantum Industrial Partners is the top shareholder in grain and livestock producer Cresud.

Although some of the land Soros ac-

quired in the past three years has as much as doubled in value, analysts say rural Argentine land remains a third to a half the price of comparable properties in the U.S. and Europe. Soros also owns 30% of commercial real estate developer IRSA Inversiones y Representaciones, which has spent \$165 million recently for several urban properties.

Soros is not alone. Italy's Benetton family raises sheep on a swath of Patagonia larger than Delaware. U.S.-based Cargill has invested \$200 million since 1994 to expand activities from soybean crushing to building grain elevators. And Agrium of Canada, along with Argentine oil company YPF and the Perez Companac conglomerate, is building a \$600 million fertilizer plant in Bahia Blanca expected to be the world's largest when finished in the year 2000.

"SECOND REVOLUTION." Argentine business leaders from media mogul Eduardo Eurnekian to former cracker company owner Carlos Reyes Terrabusi are also getting into the act. Eurnekian is using \$40 million from the 1996 sale of his local cable company to U.S. giant Telcel Communications Inc. to buy land to harvest cotton in the northern province of Chaco. Terrabusi, who sold his own company to Nabisco Inc. in 1994, has teamed up with Jorge Blanco Villegas, president of appliance maker Philco Argentina, to open a 45,000-hectare seed pool, an arrangement in which investors rent land for one season.

Encouraged by economic stability and the declining cost of credit, Argentine farmers have put more money into the land—and are reaping the benefit. Bumper crops of rice, corn, wheat, and beans contributed to this year's record 52.8 million-ton harvest. Tractor sales have increased 43%, and pesticide sales have tripled since 1991, to an estimated \$838 million this year. Meanwhile, production capacity is about to soar. For example, investors are expected to spend

about \$500 million to process crops such as sunflower and soy.

Of course, bad weather, drop in commodity prices, or rise in borrowing costs are all risks. But for many observers, the recent land grab is the start of a positive long-term trend. "This is the second revolution of the pampas—the conquest of technology," says Hector Huego, a Buenos Aires-based agricultural consultant. With the likes of Soros leading them, it's battle investors are likely to win.

By Andrea Mandel-Campbell in Buenos Aires

Boom on the Farm

INVESTOR

GEORGE SOROS

BENETTON FAMILY

CARGILL

PEREZ COMPANAC

EDUARDO EURNEKIAN

PROJECT

Farming, raising cattle, and developing commercial real estate

Sheep raising in Patagonia

Expanding grain-crushing operations by \$200 million

Building a \$600 million fertilizer plant; rice processing and forestry

Growing cotton in Chaco province

DATA: BUSINESS WEEK



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If walls like these
can come down,
surely the ones
between
engineering and
marketing can.

{ *Berlin Wall, circa 1989* }

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 **CONTROL DATA**

EDITED BY JOHN TEMPLEMAN

ARAFAT IN HIS GOVERNMENT WEAKENS ARAFAT'S GRIP

Yasser Arafat is one of the Mideast's great survivors. As head of the Palestine Liberation Organization, he has lived through assassination attempts, accidents, and ex-ile from Jordan and Lebanon. But recent events have weakened his seeming iron grip on power.

Arafat is weaker now than at any time since the creation in 1993 of the Palestinian National Authority, of which he is president. While beset by yet another halt in the peace process, he now also faces a rising tide of sleaze that is shaking him domestically. Allegations of official corruption, whispered for months, are becoming public. An internal audit unveiled recently showed that \$323 million of spending—or 10% of the Authority's budget—couldn't be accounted for. To ordinary Palestinians, who have become increasingly angry about the extravagant lifestyle, including fancy cars and other perks, of Authority officials, it seemed like the confirmation of their worst suspicions. Nearly 60% of Palestinians in a recent poll said they thought corruption was extensive.

Palestinian lawmakers are urging Arafat to resign his entire Cabinet because of the alleged corruption. Now, 16 of his 18 ministers are offering to resign. Worse yet, international donors, mostly from the European Union, have threatened to cut off \$1.4 billion of aid pledged but not yet paid to Palestine when they got word of the extent of the problem. They told Arafat privately to clean up his act.

WEAKENED POWER. Arafat's presidency is not yet threatened; he doesn't face potential rivals long ago and doesn't face elections until 1998. As a result, he is the only realistic negotiating partner that Israel has. But the allegations and the suspension of donor aid and tax receipts from Israel have put a serious dent in his power. Any economic benefit to ordinary Palestinians from the Oslo peace process has to be bankrolled

from those sources. So his grassroots support risks being leached away by such extremist groups as Hamas, which, unlike Arafat's Authority, operates a well-functioning social services network.

Rooting out corruption, however, will be tricky. There is no evidence that Arafat himself is directly implicated. But turning a blind eye to graft and sweet deals is one of the main devices he has used to control rival factions—and keep himself in power—over the years. Despite the risk of losing that clout, Arafat may have a lot to gain by dealing head-on with the problem.



ARAFAT: Saved by a crisis?

Local analysts argue that Arafat must clean house and implement a proper system of accountability, rather than just reshuffle ministers. "[Such moves] will strengthen his local position and make him more able to face external pressure," says Ghassan Khateeb, director of the Jerusalem Media & Communication Centre.

Paradoxically, the crisis in the peace process could let Arafat off the hook. When Israeli Prime Minister Benjamin Netanyahu blames him for terrorist incidents, such as the July 30 suicide bomb attack in a Jerusalem market, even Arafat's Palestinian critics rally around him. Punitive Israeli measures to seal off the West Bank and Gaza areas, where 2½ million Palestinians live, and stop payment of tax revenues due to Arafat's government have the

same perverse effect. "We are under total economic siege," says Hisham Awartani, head of economics at the Nablus Center for Palestine Research & Studies. "It's a luxury now to talk about some ministers abusing money and power."

Still, Arafat urgently needs to shore up his beleaguered domestic position. If Israel decides to put the peace process, which it controls, back in motion, Arafat's domestic problems will return to haunt him.

By Sharon Moshavi in Jerusalem

GLOBAL WRAPUP

SOUTH AFRICAN UNIONS STRIKE

South Africa's labor unions, long allies of President Nelson Mandela, are forcing a showdown with his African National Congress government. The Congress of South African Trade Unions (COSATU) called 2 million members out on a one-hour stoppage on Aug. 4 as a prelude to a series of 24-hour strikes beginning Aug. 18.

Though support for the stoppage is thin, business leaders worry that foreign investors will be scared off by

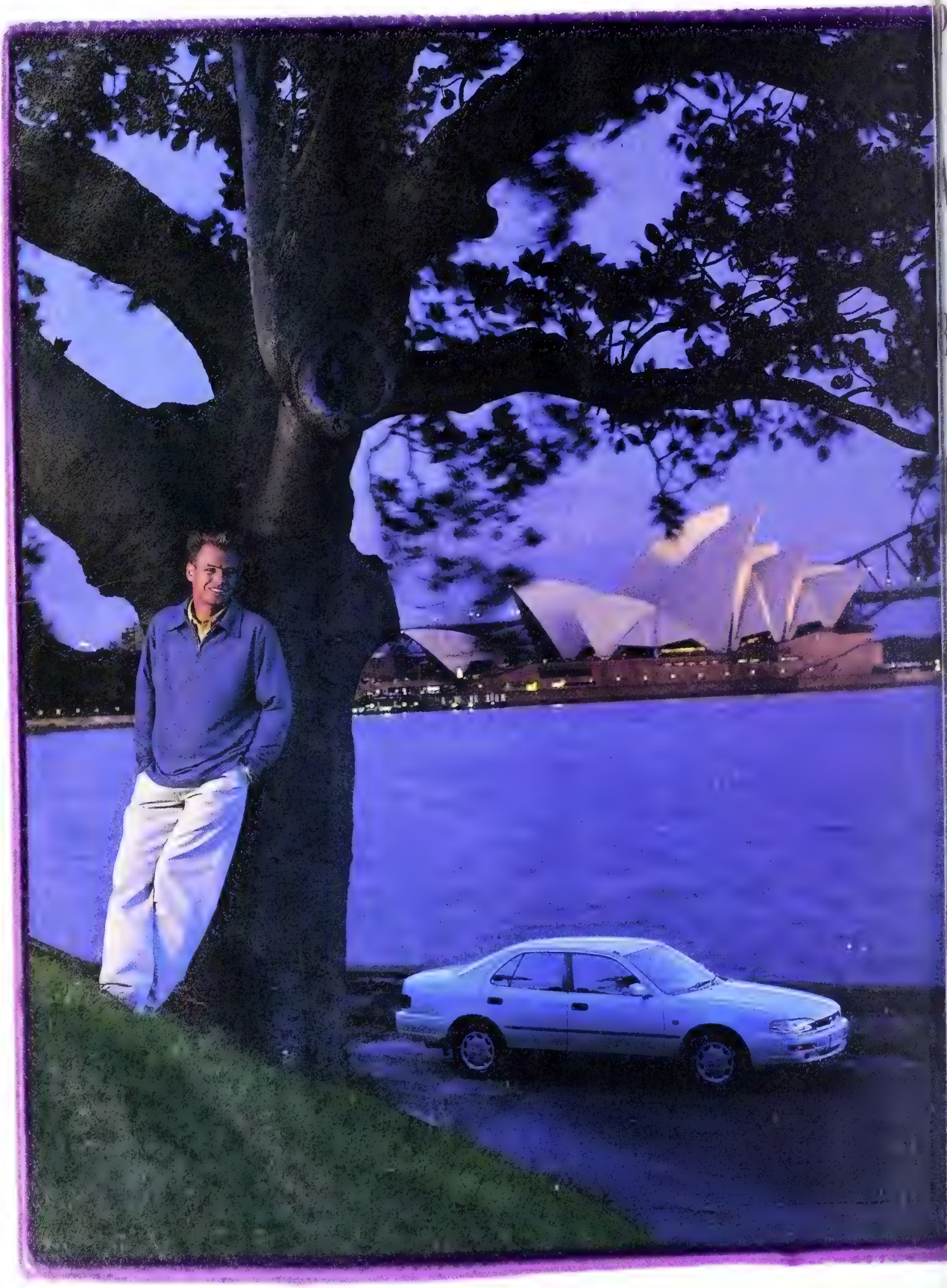
threats of ongoing labor unrest. The core union demand is for a 40-hour work week, phased in over five years. The best government offer is a 45-hour week, a big gain for many workers still required to work 60 hours. The government has promised not to ram a new law through the legislature unless it can reach consensus with its old union allies.

THAILAND MAY FACE MORE WOES

► Thailand started implementing austerity measures set by the International Monetary Fund as conditions

for a \$15 billion rescue package. On Aug. 6, it suspended all but 33 of the country's finance companies and appealed to depositors not to withdraw money, which might start a run on the nation's 15 commercial banks.

But some economists say the IMF package and \$3.3 billion of budget cuts may be insufficient to get the Thai economy back on track. Recession is more likely this year than the 3% growth forecast by government. Even hopes that the rescue package will shore up Thailand's baht may prove illusory, some argue.



PEOPLE IN
AUSTRALIA
BUILD SOME
PRETTY
AMAZING THINGS

There's one

N FRONT OF
THAT BIG WHITE
BUILDING

From the boomerang to the Sydney Opera House, Australians share a long history of ingenuity and creativity.

While the rest of the world imagines a land of beautiful beaches and cute furry animals, the locals are busy

Toyota manufacturing plant



Victoria, Australia

imagining new ways to build a better future for their country. And at Toyota, we're proud to play a part in that future.

Since 1963, Australians have been building Toyota vehicles specially designed for their country's unique driving conditions. And as Toyota's commitment to manufacturing grows - so will jobs and opportunities for other businesses Down Under.

As a company operating in the global marketplace, Toyota understands the importance of local investment. It ensures that the vehicles we sell meet the specific needs and standards of all Toyota drivers, wherever they may be. That's why, in 26 countries around the world, Toyota vehicles are built by local people.

Here in America, our second-largest manufacturing base, Toyota has invested more than \$7 billion in manufacturing, research and design. In fact, Toyota is now the fourth-largest vehicle manufacturer in America, creating over 20,000 direct jobs.

Our aim is to be a responsible local company. It's working for the people Down Under, and for people all over the world.

TOYOTA People Drive Us

SILICON VALLEY



**PRESENT AT HIGH POINTS
IN THE VALLEY:**

FROM LEFT TO RIGHT:

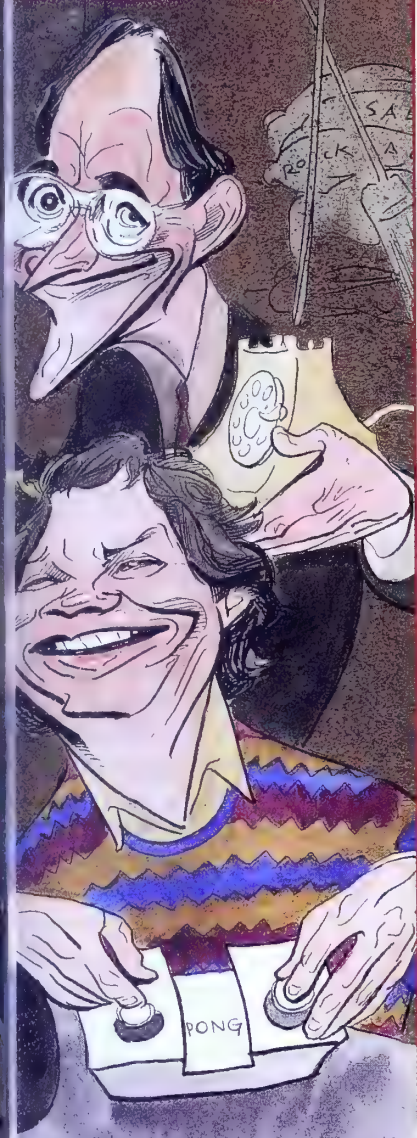
**TOP: ARTHUR ROCK,
ANDY GROVE,
BOB NOYCE, KEN
OSHMAN**

**MIDDLE: BILL HEWLETT,
DAVE PACKARD,
GORDON MOORE,
STEVE JOBS,
NOLAN BUSHNELL**

**BOTTOM: CHARLES
SPORCK, STEVE
WOZNIAK, MIKE
MARKKULA**

ILLUSTRATION BY STEVE BRODNER

KEY



Introduction

MOXIE AND MONEY How did a few orchards become the high-tech epicenter? **66**

How It Really Works

'WHAT MATTERS IS HOW SMART YOU ARE' It was brainpower that fueled the Valley's growth into the world's most fruitful business environment **68**

MYTHICAL PLACE Hollywood, Detroit, Washington, and now Silicon Valley. America's newest legendary locale won't soon be eclipsed **76**

THE WELLSPRING The community of technical scholars built by Stanford and Berkeley is at the core of the Valley **82**

MICROSOFT Outsider Bill Gates is the big, bad wolf in the Valley—and its executives know if he huffs and puffs, much of their business can get blown away **85**

Movers and Shakers

POWER BROKERS We all know the names of the kings—Steve Jobs, Andy Grove, Scott McNealy, and the like—but who are the kingmakers? Profiles of **25** **87**

SERIAL ENTREPRENEURS Quitting while you're ahead is an alien concept to many of the bright lights who start up again and again **99**

CLOSE-UP: A REPEAT ENTREPRENEUR Love among the digerati **102**

VENTURE CAPITALISTS The art of the deal, Silicon Valley-style **106**

THE IMMIGRANT FACTOR Foreign-born engineers, foreign-born entrepreneurs—no other high-tech hub can match this multinational talent pool **123**

The Culture

IPOs AND WHAT THEY WROUGHT The initial public offering has performed miracles for many startups, and its appeal is as strong as ever **124**

CLOSE-UP: WRETCHED EXCESS My jet is bigger than your jet **126**

CLOSE-UP: MILLIONAIRE RECEPTIONISTS A little equity goes a long way **130**

THE DARK SIDE The more the industry booms, the tougher it gets to afford a house, raise a family, or find office space **134**

INVISIBLE WOMEN "You run into subtle sexism every day. It's like water torture. It wears you down" **136**

Beyond the Valley

DUPLICATING SILICON VALLEY Many regions have tried to recreate the magic. None has succeeded **138**

CLOSE-UP: TAIWAN The nation's new grail is innovation **139**

CLOSE-UP: MALAYSIA Amid the rubber trees, a multimedia corridor? **140**

CLOSE-UP: CAMBRIDGE A college town becomes a hotbed of homegrown tech **142**

LESSONS FOR OTHERS Much of what makes Silicon Valley great can be applied to companies of all stripes **146**

Business Week Online Supplemental material will be available on our online magazine, www.businessweek.com including expanded graphics, interviews, maps, and a photo scrapbook



COMPLEMENTARY COVERAGE ON CNBC

In-depth reports throughout the week of Aug. 8-15, airing at 10 a.m. and 5 p.m. EDT

AUGUST 8

PROFILE: Gordon

Moore, Intel

PROFILE: A Young
Millionaire

AUGUST 11

Finding Capital

PROFILE:

Ann Winblad,
Venture Capitalist

AUGUST 12

**Getting Great
Talent**

**Keeping Great
Talent**

AUGUST 13

PROFILE:

Frank
Quattrone,
Investment
Banker

AUGUST 14

Employee

Burnout

Real Estate
Squeeze

AUGUST 15

LIFESTYLE:

**A Case Of
Overload**

PLUS: Interviews featuring the stars of Silicon Valley and BUSINESS WEEK reporters all week.

WHO COULD HAVE DREAMED, 40 YEARS AGO, THAT THE EIGHT disgruntled engineers who marched out of Shockley Semiconductor Labs in Mountain View, Calif., would set in motion one of the most amazing chain of events in American business history? They would come to be known as the Traitorous Eight, young men with an average age under 30, each with his genius barely tapped. Among them were visionaries such as Robert N. Noyce, Gordon E. Moore, and Eugene Kleiner. They quickly founded Fairchild Semiconductor Corp., a pioneer in creating semiconductor chips from silicon alone. More important, they began an entrepreneurial tradition that planted the seeds for 45% of U.S. industrial growth. And nowhere is that engine humming louder than in Silicon Valley, where 20% of the world's 100 biggest electronics and software companies have taken root. Indeed, the \$450 billion market value of the publicly held tech companies in and around the Valley is approaching that of the entire French stock market.

HOW IT REALLY

that became Silicon Valley.

Look at what they've wrought. Noyce and Moore went on to found mighty chipmaker Intel Corp., which led to at least eight more spin-offs, and Kleiner helped stoke the Valley's money machine when he launched the region's premier venture-capital firm, Kleiner Perkins Caufield & Byers. Today, there are some 7,000 electronics and software companies and thousands of startups here, with 11 companies being created every week—all crammed into a 50-mile-long corridor, like transistors on a powerful chip.

The combined effect is electrifying. For the past four years, the Information Revolution has driven the U.S. economy and touched lives around the world. While enhancing efficiency even as companies slim down, the mere production of computers and semiconductors accounted

What transformed a patch of prune orchards into the epicenter of global technology, where 11 new companies are created every week? BUSINESS WEEK offers an in-depth look at what makes Silicon Valley tick

The resulting wealth is staggering. Last year, on average, a Valley company went public every five days, minting 62 new millionaires every day. Wages grew 5.1%—five times the national average. And now, T-shirted tycoons are plunking down cash for million-dollar homes in exclusive enclaves such as Saratoga and Los Altos Hills. Says L. John Doerr, a partner at Kleiner: "This is the largest single creation

of wealth and economic activity to be seen in a compressed period of time."

This may not be the Industrial Revolution, but in this technology-blessed realm, the much-lauded postindustrial society is a reality. Here you can reap wealth from sheer brainpower, with most of the manufacturing and assembly done elsewhere. True, the median home price in June hit \$319,000, out of reach for 70% of Valley residents. Yet

h concerns haven't slowed the influx of entrepreneurs from around the world (page 123). How did Silicon Valley reach this zenith? What transformed a former patch of apricot and prune orchards into the epicenter of global technology? And how does this fearless embrace of innovation really work? Over the past two months, BUSINESS WEEK's staff has augmented years of elite coverage with more than 300 interviews with movers and shakers, behind-the-scenes power brokers, and the rank and file to scope out what makes the Valley tick. What we found was a huge brain trust, companies galore to service the tech machine, and a

ture capitalists to custom chip designers. "There are a lot of people in Silicon Valley who can put companies together for you in an afternoon," boasts Steven P. Jobs, co-founder of Apple Computer Inc. and NEXT Software Inc. (page 106).

That's just part of the formula. A big chunk of the equation is the Valley's culture—that component that's usually discounted as too squishy to quantify. In this case, it has put an indelible risk-taking stamp on the way the Valley operates. Combine that with the paranoia, born out of the bust years of 1985-86, when computer-industry woes wiped out jobs and some began calling it the Valley of Death, and the result is a hyper-

VALLEY WORKS

redevil, risk-taking culture. To be sure, the universities in the region have been a powerful contributor. In particu-

Stanford University professor Frederick E. Terman set the tone in the 1930s by fostering entrepreneurship and technical excellence. His legacy is a rich one. He encouraged two of his students, William Hewlett and David Packard, to turn their idea for an

audio oscillator into a company. What followed was not just the birth of a powerhouse but a series of Hewlett-Packard Co. progeny that populated the region with new technologies (page 82).

This process has built a critical mass in the Valley, where the ability to transform a concept into a company has reached an art form. The tech infrastructure includes everything from ven-



competitive environment where seven-day workweeks have turned companies into 24-hour communities (page 68).

The Valley has its flaws. Not only is it expensive and overcrowded but the frenetic pace leaves little time for relationships and family (page 134). And, despite the Gold Rush atmosphere and a claimed meritocracy where all that counts is smarts

and hard work, there are few women running companies and wielding influence (page 136).

Still, businesses around the globe can find lessons here: Take risks, then create an environment for incubating ideas. Add speed. Add supercompetitiveness. And never rest on your laurels (page 146). The Valley has much to celebrate. So, on its big 40th, we offer a look at a place where amazing things happen. □

How the Valley Began... and How It Grew



PACKARD

1931

Stanford sophomores David Packard and William Hewlett become friends as benchwarmers on the varsity football team.

1938

Fred Terman, Stanford professor of electrical engineering, loans Hewlett and Packard \$538 to produce an audio oscillator, their first instrument made while toiling in a Palo Alto garage.



TERMAN

1955

Dr. William Shockley, co-inventor of the transistor at Bell Labs, returns to his hometown of Palo Alto and founds Shockley Labs Inc.

'WHAT MATTERS IS H

What makes the Valley go round? Good ideas, mostly—plus a unique, risk-taking ecosystem

They came from India, Pakistan, and the heartland of America, by way of Illinois, Boston, and North Carolina. The three men quit good academic jobs, left their homes, and packed up their cars for the long drive across the U.S. Their Conestoga wagons were a Mazda, a Toyota, and a Jeep. Their campfire stories were told over cellular phones as they barreled across the plains. Their dream was to build a high-tech company, and they believed to do that, they had to get to Silicon Valley. "We're coming, no matter what," Resve Saleh recalls telling a venture capitalist on the phone. "We have to be near Intel."

The trek paid off. In an office park five minutes up the road from Intel, the trio has launched Simplex Solutions, which makes software for simulating chip designs. Just two years after their cross-country pilgrimage, the company has raised \$11 million and employs 55 people. Simplex' software already has won over such customers as Silicon Graphics Inc. and Hitachi Ltd. Now, Saleh and his partners are racing toward a new milestone: taking their company public within the next two years. Marvels the 40-year-old Saleh: "This has exceeded our wildest expectations."

PUMPING UP. Everyone else's, too. Silicon Valley. Rich in ideas. Richer in dollars. And all on the back of the biggest industrial revolution since the internal-combustion engine: computer technology. Some 20% of the world's 100 largest high-tech companies make their homes here. Zip 10 minutes down Highway 101, the main artery that hums through the Valley, and you pass powerhouse after powerhouse: Intel, Cisco Systems, 3Com, Sun Microsystems, Netscape Communications—those five alone boast combined revenues of \$40 billion and a \$257 billion market capitalization. More than the market value of General Motors, Ford, and Chrysler combined.

The region is intoxicated with such successes. In the past two years, the Internet craze and hot new startups pumped up an already vibrant economy into one busting at the seams. In 1996,



on average, one Valley company went public every five days, adding 62 new millionaires every 24 hours. More than 50,000 new jobs were created, while wages grew five times the national average. Last year, the region led the U.S. in worker productivity and export growth. "This is an economic miracle taking place, right before our eyes," says Thomas M. Siebel, the founder of Siebel Systems Inc., a software maker that raised \$33 million when it went public in June, 1996.

Such vitality has transformed Silicon Valley into the quintessence of the American Dream. Any good idea in a garage can turn into a gold mine. No pedigree required. What's more, a bi

 For more on the workplace: See CNBC at 10 a.m. CNBC and 5 p.m. EDT Aug. 12; McNealy at noon Aug. 1

SMART YOU ARE'



nk of the wealth that's being created is being
tributed far beyond the corner offices, thanks
he Valley's stock-option culture where em-
ees can buy shares in startups and giants
e at prices below market value—then cash in
when the stock takes off.
hat has made this 50-mile-long corridor,
ching from San Jose to San Francisco, the ul-
ate destination for those drawn to the digital
l rush. In 1995 and 1996, Saleh's company
s just one of 900 startups that set up shop
e. And the pace is only accelerating: In 1997's
t quarter, 147 new hopefuls joined the ranks,
ording to Price Waterhouse. "It's an elixir
t you breathe in the air as you come to this
t of the world," says Christos M. Cotsakos,
of Palo Alto-based online brokerage
Trade Group Inc., which went public last

EXCITE Redwood City

**Employees use
bicycles to zip
around the
company's
cavernous
headquarters**

70% of the residents. Anyone caught on the
clogged 101 knows that traffic delays are just
one of the aggravations in the jam-packed Valley.
And the reality is that few dreams are real-
ized—only one in 10 startups hits it big, six
limp along, and the rest are destined to im-
plode, shattering dreams and swallowing hopes.

But that one that makes it—ah, that not only

summer, raising \$46 million. "I
have never seen anything like
this. This is Mecca."

Mecca maybe, but not heav-
en. The Valley has its dark
side. For one, it's expensive to
live here—the median price of
a single-family home hit
\$319,000 in June, up 14% from
a year ago and out of reach for

SEPTEMBER, 1957

The so-called Traitor-
ous Eight, including
Gordon Moore and
Robert Noyce, walk
out of Shockley Labs



MOORE

and found Fairchild
Semiconductor, the
first company to work
exclusively in silicon.

JULY, 1959

Robert Noyce of
Fairchild files a
patent for the inte-
grated circuit.

1964

Gordon Moore pro-
jects the number of
transistors that can
fit onto a chip will
double every two
years. This will be
known as Moore's
law.

JULY, 1968

Noyce and Moore
resign from Fair-
child. Each puts up
\$250,000 to found
Intel Corp.

NOVEMBER, 1971

Intel produces the
first microprocessor,
which is called the
4004.

NOVEMBER, 1972

Nolan Bushnell, who
quit
Ampex
and
founded
Atari
with



\$500 out of his
pocket, ships the
pioneering Pong
video game.

APRIL, 1976

Steve Jobs and

SILICON VALLEY HOW IT REALLY WORKS

Steve Wozniak launch Apple Computer and debut the Apple I at the Homebrew Computer Club in Palo Alto.



APPLE II

SEPTEMBER, 1976

Shugart Associates ships the first floppy disk drive for PCs.

1977

With \$1,200, Larry Ellison launches Software Development Laboratories, which will become database powerhouse Oracle Corp.

DECEMBER, 1980

Apple goes public, at \$22 a share, the biggest public offering since Ford in 1956.

FEBRUARY, 1982

Sun Microsystems is founded by three Stanford students, Vinod Khosla, Scott McNealy, and Andy Bechtolsheim.

APRIL, 1983

John Sculley joins Apple as president



SCULLEY

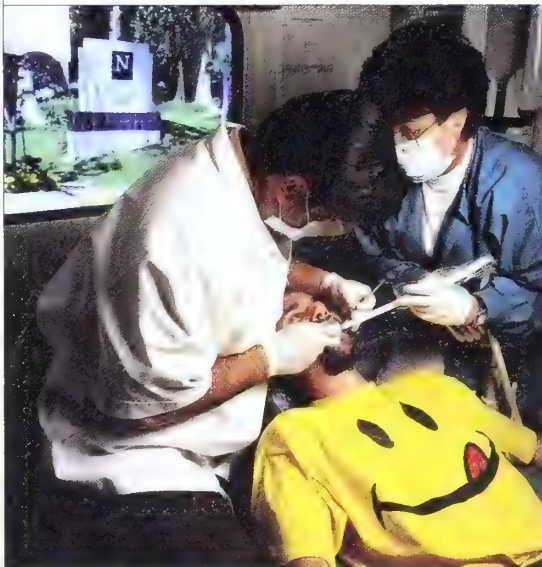
and chief executive, signaling a new era in the Valley as tycoons give way to seasoned managers.

MAY, 1983

Philippe Kahn, the French-born, sax-playing mathemati-

cal brings riches but the chance for an engineer or programmer to change the way people work and play. For all the talk of money in the Valley, there is just as much verbiage about "making a difference"—in how people get information, crunch it, use it, and entertain themselves with it. "I'm not in it for the wealth anymore," says Oracle Corp. CEO Lawrence J. Ellison, who's worth \$8.4 billion. Why, then? "How much difference can one person make?" he asks. "All the difference in the world."

Making millions and making a difference is the Silicon Valley mantra. But the machinations behind that—the dissection of how that really works—is a complex study in amassing a deep



NETSCAPE Mountain View

Can't get to a dentist? There's care available in the parking lot

talent pool, building infrastructure, and then overlaying it all with a can-do, break-the-rules culture. The contribution of Stanford University and the University of California at Berkeley, which have fed the maw for brainpower, cannot be underestimated. But that was just the first component in a complex formula that, so far, has not been repeated anywhere else in the world.

Perhaps the biggest factor in Silicon Valley's success is its sheer density. The region crosses 30 city lines, but it's basically a one-industry town crammed with some 7,000 electronics and software companies, and more in the making. Even the tech heavies from elsewhere think they need a presence here—Microsoft Corp. has sales reps in Foster City and programmers in Cupertino; Sony Corp. set up a research center in San Jose; and Taiwanese PC giant Acer Inc. built research and development, engineering, and manufacturing facilities in San Jose.

That creates a synergy with exponential effect. Executives rub shoulders at work, at the corner Starbucks, and on hiking trails. A breakfast at Palo Alto's trendy Il Fornaio or Woodside's down-to-earth Buck's quickly becomes a

dealfest for a venture capitalist or a jam session for engineers on the latest advances in gigabit ethernet. "You end up seeing each other at parent-teacher nights," says Heidi Roizen, a former Apple exec. Adds Intel CEO Andrew Grove: "Proximity helps. People have work with each other, competed against one another. We have such a rich ecosystem."

The result is nonstop cross-fertilization. Take Netmosphere Inc., an Internet Java software startup. Like so many Silicon Valley stories, began with a chance meeting between an engineer and a marketer at a January, 1996, party in San Francisco. Eric Ly, now 28, had designed software for General Magic Inc.; Heather Ros-



v 33, was the product manager who launched lockwave animation software for Macromedia Corp. Both were looking for new challenges on Net. Ly obtained \$300,000 in private seed funding, and the San Mateo-based company has reached its first product: Net software for managing big projects. Now, Rose is looking for \$3 million in venture capital.

This is where the Valley's impressive infrastructure comes into play. Over the years, the region has fine-tuned the task of transforming concepts into companies. About half the nation's venture-capital firms are based in the Valley, according to the National Venture Capital Assn. And many of them have offices on Sand Hill

compensation insurance to a customized benefits plan overnight, says CEO Martin Babinec.

Even today, Sun Microsystems Inc. CEO Scott G. McNealy marvels at how fast the cogs whirl. In 1982, he and two other 27-year-olds with close to zip experience managed to raise \$250,000 in venture capital on the whisper of an idea—

making powerful workstations.

"We were able to open a checking account on our word. We were able to rent buildings without showing ID. We were able to get phone lines, and Wilson Sonsini filled a huge boardroom table full of docu-

GEEK HOUSE Santa Cruz

**Programmers
and engineers
hit the hot tub,
laptop in hand**



KAHN

cian, launches Borland International. He would become a database king before Borland started to fizzle in 1993.



VIRTUAL WEDDING San Francisco

**Online wedding
sites are
changing online
the Valley**

Road in Menlo Park, smack dab in the center of the action. These players fork over the necessary cash and knowhow in hopes of 30% returns or a megahit.

They are essential to the Valley. Over the past four

years, venture capitalists have plunged some \$5 billion into Valley tech startups, 37% of all information-technology investments in the U.S., according to VentureOne Corp. And they're not alone. Hundreds of other supporting-cast members have been drawn to feed on the tech food chain, from lawyers who know the ins and outs of software and patents to suppliers of machine tools—all with ready expertise for a novice entrepreneur.

It's an instant company-making machine. With the touch of a button, boilerplate stock-option plans and prospectuses roll out of the word processors at the law firm of Wilson, Sonsini, Goodrich & Rosati in Palo Alto. The nation's largest human-resources outsourcing firm, TriNet Employer Group in San Leandro, can set up everything from payroll processing to workers'



ments for us to sign," he says. "Actually, on their word processor, they just changed a previous name to our name."

But this is just half the formula. A big part of Silicon Valley's success comes down to something that cannot be quantified: the culture. This is one of the most unusual business environments on the planet, where the traditional ways of doing business have been turned on their ear. At the core of this is an all-things-are-possible attitude, an unerring belief that a new technology, an entrepreneur's vision of the digital future, is the absolute right one. And if it isn't, well, the next one will be.

It is Daredevil Business 101, where risk-taking is the norm and the penalty is not for failure but for not trying. This has created a wide swath of so-called repeaters, entrepreneurs who may start a company and crash but will try it again with the blessing and the bucks from venture backers. This is how the theory goes: Good

JANUARY, 1984

Apple introduces the Macintosh.

DECEMBER, 1984

Husband-and-wife team Leonard Bosack and Sandra Lerner found Cisco Systems to develop networking technology.

JUNE, 1985



Steve Jobs is ousted from Apple after losing a power struggle with Sculley. He founds NEXT Inc.

SILICON VALLEY HOW IT REALLY WORKS

DECEMBER, 1989

Conner Peripherals shoots to \$705 million in revenue, the fastest-growing manufacturing startup in history.

MARCH, 1993



PENTIUM CHIP

Intel unveils its most powerful processor to date, the Pentium, which establishes its dominance. Today, Intel's market capitalization is a stunning \$163 billion.

APRIL, 1994

Jim Clark and Marc Andreessen found Netscape Communications as Mosaic Communications. Netscape goes public in August, 1995, at 28, jumping to 75 before closing at 58 the first day.

NOVEMBER, 1995



CARTOON HIT

Steve Jobs's Pixar releases the first computer-animated hit film, *Toy Story*.

JULY, 1997

Apple CEO Gil Amelio resigns and Jobs takes an "expanded role."



AMELIO RESIGNS

ideas are the most precious commodity, and an entrepreneur who has them and stumbles comes away with enough lessons to get it right the next time.

Lucky for William G. Paseman, a former oil-rig worker from Houston who got an engineering degree from Massachusetts Institute of Technology and headed West. In 1986, he started Atherton Technology to make object-oriented programming tools for speeding up software development. For five years, he says, "we made every mistake we possibly could. You could have burned a BMW in the parking lot every day at our run rate." The company went bust.

But soon, Paseman had another idea. He discovered that companies doing business in Europe had trouble working with the varying electrical-emissions standards in different countries. He came up with a software program to help them navigate "the pain." Knock, knock—he went calling on his Atherton venture backers, including the Mayfield Fund. Once again, they took out their checkbooks to the tune of \$2.9 million, backing Calico Technology Inc. Says Mayfield partner Yogen K. Dalal: "Failure is not a black dot in the Valley, it's a badge of merit."

IT'S THE IQ. The only thing more vital than taking a risk is having an idea. The push to come up with bigger, better, faster, and cheaper technology has thrown open the door to all comers. In the Valley, people rarely care what school you attended, your ethnic background, or your family pedigree. They want proof of iq. And with the exception of the lack of women and African Americans heading companies, it works. "Silicon Valley is a meritocracy," says Steve Jobs, co-founder of Apple Computer Inc. "It doesn't matter what you wear. It doesn't matter how old you are. What matters is how smart you are."

That worked to the advantage of two entrepreneur-wannabes then at FirePower Systems. The pair went to see venture capitalist Steve Jurvetson at Draper Fisher Jurvetson. But the investor was unimpressed by their idea for database software for the Net. As they were packing up to leave, he asked: "Do you have any other ideas?" Sabeer Bhatia, one of the engineers, said they'd noodled over a scheme to offer free, advertising-supported E-mail over the Web. A week and a half later, the venture capitalists ponied up \$300,000 (no business plan required), and Hotmail was born. Today, it claims some 4 million subscribers.

Such reinvention is the lifeblood of Silicon Valley. Throughout the decades, from the days when industry pioneers Charles Sporck and Ken Oshman and venture backers Arthur Rock and Mike Markkula were the Valley's movers and shakers, the Valley has constantly remade itself just in time for the Next Big Thing. When

the computer industry went into a tailspin from 1984 to 1987 and high-tech employment plunged 11%, to a low of 191,900 jobs, the Valley emerged with desktop-publishing software and powerful workstations.

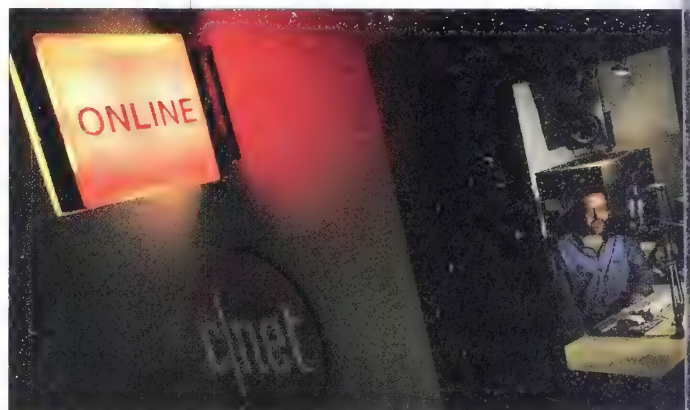
POWER BROKERS. And nowhere were techies quicker to latch on to the Big Kahuna—the commercialization of the Net. Now, the Valley already in overdrive, has entered Internet time.

Kleiner Perkins Caufield & Byers partner John Doerr, one of the Valley's top power brokers, carries a pager, phone, personal digital assistant, or laptop wherever he goes—he can't risk missing an opportunity. John R. Koza,

CNET
San Francisco

The radio-like booth flashes a different announcement

consulting professor of computer science at Stanford, is a massively parallel computer in a spare room of his hillside home so he can plumb the frontiers of programming all hours. Who knows—maybe Koza, who made his fortune



designing instant lottery programs, might hit big again.

These days, companies are trying every trick imaginable to cut even minutes out of normal routines. Macromedia Inc., a multimedia software company, has installed a slide between floors to get engineers to their destinations fast. Internet startup Excite Inc. has stashed pink bicycles throughout its offices so workers can zip to one another's cubicles in the cavernous digs.

Now, Valley companies are even beginning to look like 24-hour planned communities. Netscape, a Winnebago stocked with dentists shows up twice a week for workers who can find time for checkups. At networking maker 3Com Corp., employees can get film developed at the company store and their car washed in the parking lot. And weary engineers at Net star up PointCast Inc. keep washers and dryers humming around the clock. "These startups," says Marc Andreessen, co-founder of Netscape, "demand virtually a Herculean effort from all the employees."

So far, they're getting it. Which is why Silicon Valley keeps spinning good ideas into gold.

By Andy Reinhardt, with Joan O'C. Hamilton and Linda Himmelstein in Silicon Valley

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TAKING ITS PLACE IN THE

In the economic history of 20th century America, few places have achieved larger-than-life, almost legendary status. Wall Street, Detroit, and Hollywood—these names are synonymous with financial might, manufacturing prowess, and glamour. At times, they have dominated the rest of the economy, ruling over their industries and captivating the national imagination.

Now, Silicon Valley has joined the pantheon of mythic places—the first addition in more than 50 years. The Information Revolution is driving economic expansion, with computers and semiconductors accounting for some 45% of industrial growth since 1993. And Silicon Valley is the apotheosis of this revolution. Tech companies based in and around the Valley now have a market value of some \$450 billion—a number approaching the market capitalization of the entire French stock market. As a group, these companies have trailblazed the business behavior and culture that define the Information Economy. (For a roster of the Valley's largest public companies, see www.businessweek.com.)

In the U.S., the only locale with near-comparable economic heft is Wall Street. Like high-tech companies in the Valley, New York-based financial-services companies have an aggregate market value of about \$400 billion. By comparison, the auto companies and suppliers of Detroit—erstwhile epicenter of the manufacturing economy—are worth barely \$100 billion.

MIND GAME. That puts Silicon Valley front and center. What's more, if the economics of mythic places holds true in this 50-mile corridor of startups and technological creativity, it won't lose its starring role in the Information Economy. True, the cost of living and doing business are far higher than in other places. But that matters less than issues such as the deep pool of top-notch people and suppliers, the chance for individuals to get rich—often, quick—and the readiness to latch onto change. These qualities simply cannot be duplicated elsewhere. Just as Hollywood and Wall Street draw the starstruck and money-

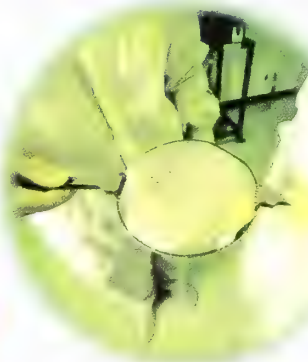
minded elite, Silicon Valley attracts the best and brightest minds in technology.

Indeed, Silicon Valley is gaining a bigger share of brainpower across a wide array of industries. Semiconductor jobs in the Valley are up by 29% since 1993, according to Collaborative Economics Inc., a Palo Alto-based consulting firm, outpacing a 20% semiconductor gain nationwide. Software jobs

are up an astounding 70% since 1993, double the national average, despite the costs and congestion of the area. "We were worried that all of California's brains would go to Idaho or Santa Fe," says Larry J. Kimbell, director of the UCLA Business Forecasting Project. "But the opposite is happening."

Moreover, Silicon Valley has shown time and again that it can reinvent

Legendary Locales



CHIP EXPRESS IN SANTA CLARA, CALIF.



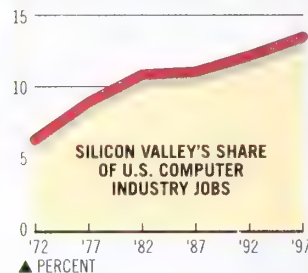
SUMMER SCI-FI: MEN IN BLACK

SILICON VALLEY

MARKET VALUE:
\$452 BILLION

SHARE OF U.S. HIGH-TECH MARKET VALUE:
37%

The region surrounding Stanford University has attracted technology companies since Hewlett-Packard was founded in 1939. Threatened by Japanese competitors in the 1980s, Silicon Valley bounced back in the **1990s** to become the cutting edge of the Information Economy.

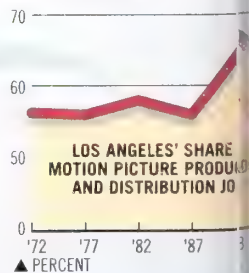


HOLLYWOOD

MARKET VALUE:
\$56 BILLION

SHARE OF U.S. ENTERTAINMENT MARKET VALUE:
55%

Southern California has led the world in movies and glamour since World War I. Movie attendance peaked in **1946** but then fell way off after television was introduced. Hollywood adjusted by becoming the biggest supplier of television programming.



DATA: STANDARD & POOR'S COMPUS BUREAU OF LABOR STATISTICS, BUS.

ANTHEON

Silicon Valley's starring role in the Information Economy isn't likely to be eclipsed any time soon

—a quality that will be key to its survival. Consider this: Wall Street and Hollywood have dominated the securities and movie industries since the 1920s, adapting to changing conditions. In contrast, U.S. auto makers, which date to the same period, became ossified and inflexible. While a substantial share of auto jobs remain in Detroit and its suburbs, the area is no longer a font of

cutting-edge thinking. Foreign auto companies locate their new factories in Tennessee or South Carolina, not Detroit, while foreign technology companies are flocking to Silicon Valley.

How long can its dominance continue? Indefinitely—since it is both the engine and the model for the rest of the economy. The Valley's industrial landscape is America's dreamscape: tight links among

companies and top-notch universities, unlimited access to venture capital, a roiling influx of brilliant engineers from around the world, and a diverse mix of high-tech companies, both large and small. What's more, the Valley is self-replenishing. The proceeds from one company's success are plowed back into the next generation of startups. "The wealth that has been created there

DETROIT

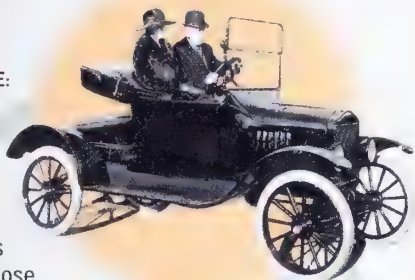
MARKET VALUE:

\$113 BILLION

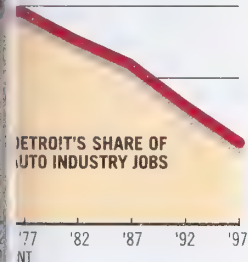
U.S. AUTO MARKET VALUE:

64%

Ford's introduction of the Model T in **1908** reshaped Detroit as the automotive capital and symbol of America's manufacturing prowess. Those years were not seriously challenged by the success of Japanese cars in the 1970s and 1980s.



1920
MODEL T
RUNABOUT



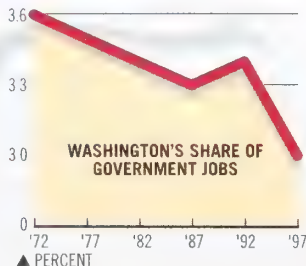
PRESIDENT
LYNDON
JOHNSON

WASHINGTON

SIZE OF FEDERAL BUDGET:
\$1.6 TRILLION

SHARE OF U.S. ECONOMIC OUTPUT:
21%

Washington became a center of economic power when the New Deal tripled the federal budget from 1929 to **1937**. World War II and Lyndon B. Johnson's Great Society added to Washington's heft, but the tight budgets of recent years have reversed the trend.



MAKING
TRADES,
THEN AND NOW



WALL STREET

MARKET VALUE:

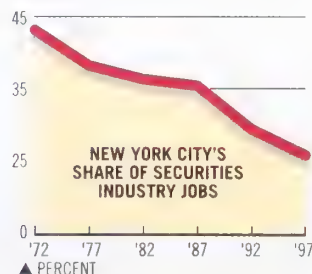
\$405 BILLION

SHARE OF U.S. FINANCIAL SERVICES

MARKET VALUE:

26%

By **1918**, Wall Street had replaced London as the exemplar of capitalist might. The 1929 crash shook the Street, as did the 1980s rise of well-financed Tokyo competitors. Despite losing back-office jobs, Wall Street still leads in financial innovation.

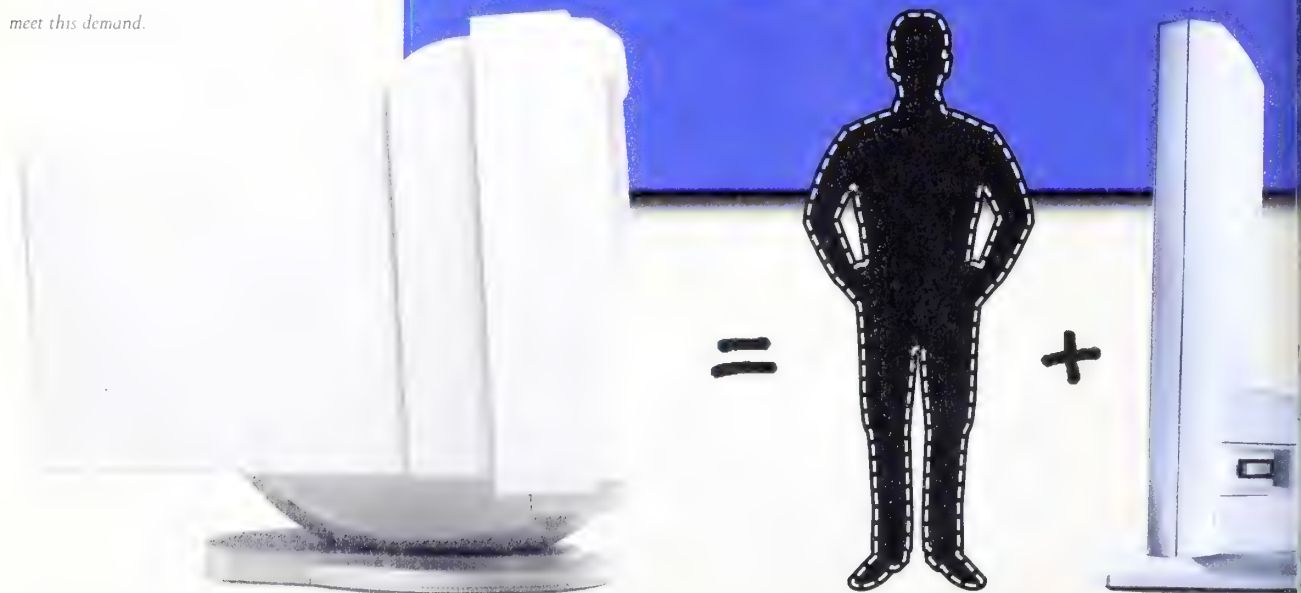




REPLACING A
BIG, BULKY CRT

*with a slim flat panel display
actually makes room for more
traders on the floor. Which is
a good thing, since the trading
volume on the major exchanges
is higher than it has ever been in
the past. The increased volume
in trades means that there is an
even greater need for traders to
meet this demand.*

**Perhaps the first
instance where
computers are
being replaced
by people.**



IN A FREE MARKET ECONOMY, companies are always competing for capital. In fact, the market has never been more competitive than it is today. It increases the number of specialists needed to trade stocks. It also puts an additional burden on the technology needed to support this effort, since traders need to constantly monitor as many as four or five displays to stay abreast of market news and economic data.



NEC MultiSync LCD2000
20.1" Viewable LCD Monitor

Street at least, it's clear that less may actually be more. Because replacing big, energy-hogging CRTs with slim flat displays allows you to put more traders on the floor of the exchange. Take NEC Technologies' new MultiSync® monitors, including the world's first available 20.1" viewable LCD. These remarkable flat panel displays take up 60% less space and weigh 70% less than traditional monitors. Size, however, is not what sets them apart. Our XtraView™ technology provides clear and accurate images of the screen at

virtually any angle (which comes in handy when you're straining to see over the shoulder of another trader). These monitors produce a brighter, sharper image than many CRTs. They eliminate eye-fatiguing flicker (which traders will appreciate since they have to keep an eye on so many displays). They also consume up to 50% less power and have much lower emissions. Plus they're compatible with most PCs, Macs and workstations. To learn more, call 1-800-NEC-INFO.

Or, if you prefer, please visit us at www.nec.com. Expect more. Experience more.



THE TRADING FLOOR is crowded

with specialists. The trading floor is also crowded with big, bulky CRTs that take up precious room. These CRTs also hog energy and produce a tremendous amount of heat. (Besides, as any trader will tell you, it's already "hot" enough on the trading floor.)

MultiSync® LCD Monitor Series		
	LCD2000™	LCD400™
Viewable Size	20.1"	14.1"
Maximum Resolution	1280 x 1024	1024 x 768
Weight	22.0 lbs	11.5 lbs
Dimensions (W, H, D)	19.7 x 19 x 8.7"	14.1 x 14.3 x 6.7"
Brightness	150 cd/m	180 cd/m
Viewing Angle	160° conical XtraView technology	160° conical XtraView technology
Both models are compatible with PC, Mac, workstation or any VESA compliant analog RGB signal, no special card required		

MORE TRADERS MEANS MORE TRADES, which means more money. (And let's be completely frank, shall we, what financial person doesn't like news like that?) In fact, one could even argue that moving from big, bulky CRTs to slim flat panel monitors like the MultiSync 2000 could actually put a positive spin on the term 'downsizing'.



stays there," says Mitchell L. Moss, an urban economist at New York University's Wagner School of Public Service.

A historic pattern also bodes well for the Valley. Mythic places, it seems, are not subject to the same cost constraints as other locales. Wall Street and Hollywood continue to thrive even though New York and Los Angeles have long been among the most expensive areas in the country.

By these standards, the congestion and high costs in Silicon Valley, as aggravating as they may be, are not out of line. Hourly manufacturing earnings are about 25% higher in Silicon Valley than elsewhere, but that's down from the 29% wage differential in 1992. Home prices this year are up sharply. Still, the gap with the rest of the country is no wider than it was in the early 1990s.

Perhaps a bigger problem is finding space in the Valley, which has long favored sprawling one- or two-story structures. Increasingly, companies cope by building up rather than out. Adobe Systems Inc. chose to build a new 18-story headquarters in San Jose. "You don't need to have spread-out facilities," says Douglas Henton, president of Collaborative Economics.

Can anything topple Silicon Valley? Its biggest strength today could be its most vulnerable point down the road—technological innovation. Here, Detroit offers an object lesson. The early auto-industry pioneers were intensely creative, with steam-powered and even electric-powered cars vying with gasoline models. Auto makers had little money for large manufacturing operations, so they relied on parts and components bought from outside vendors. Indeed, Detroit's initial competitive advantage over other areas came from its unmatched pool of skilled craftsmen, machine shops, and other suppliers. "In its early days, Detroit looked a lot like Silicon Valley," says Susan Helper of the National Bureau of Economic Research. **OUT OF GAS.** But the astounding success of the big auto companies in the 1920s helped destroy the industry's flexibility. As car sales tripled from 1921 to 1929, Ford Motor Co. and General Motors Corp. started making most of their own parts, eliminating the supplier network that had nurtured the industry. Henry Ford went so far as to process his own iron ore, and he rejected using aluminum because he couldn't control aluminum makers. Bendix, which invented fuel injection for fighter planes during World War II, couldn't get U.S. auto makers to use the new technology for years. No longer open to ideas from the outside,

Detroit grew vulnerable to foreign competition. Ironically, the same strategies that had increased profits and control in the past had the effect of hermetically sealing the industry from within.

If you heed the paranoid rants on the Internet about the dangers of Intel Corp.'s high-tech hegemony, you may fret that Silicon Valley is headed down the same path. Hasn't Intel extended its influence from microprocessors to motherboards, whole PCs, networking devices, and supercomputers? Isn't Intel, even now, trying to take control of the graphics-chips market with its purchase of Chips & Technologies Inc.? Could Intel, in short, trigger a cascade of events that

cutbacks in the late 1980s and early 1990s that cost 40,000 jobs. By comparison, Boston's Route 128 is a cautionary tale. The minicomputer companies that made the region a major technological force in the 1980s—including such giants as Digital Equipment, Wang Laboratories, and Prime Computer—all failed to adjust to changes in the marketplace, especially the personal-computer revolution.

Not Silicon Valley. The diversity of its companies and workforce created a more complex and robust economic environment than ever existed in Detroit or along Route 128. This try-anything milieu, what enabled Netscape Communications Corp. to hurl Microsoft Corp. a curve-

 **GIVE IT A TRY** *The Valley's future rests on its continued ability to reinvent itself. Detroit lost its hegemony when it became closed to outsiders and their ideas*

sends Silicon Valley sliding down the same slippery slope as Detroit?

Most Intel-watchers say the giant is too shrewd to fall into such a trap. It is more likely that Silicon Valley as a whole will follow Hollywood's model. From 1946 to 1956, Tinseltown's movie industry saw attendance drop by half as television became popular. New York, home to the TV networks, was the source of most early programming. But Hollywood struck back. In 1954, Warner Brothers made the first deal to produce films for television. By 1957, virtually all the dramas on TV were coming from Hollywood. Meanwhile, it kept its original franchise. Today, almost all of the highest-grossing pictures globally still come out of Hollywood.

Wall Street has also been forced to reinvent itself. In the late 1980s, the focus of global financial power seemed poised to shift to Tokyo and London, with U.S. brokerages seeking out the biggest pools of capital. Fleeing New York's high costs, many Wall Street firms moved back-office operations out of Manhattan. Still, these companies have prospered by generating wave upon wave of financial innovation. "The search for new ways to make money is what New York specializes in," says NYU's Moss.

Like Hollywood and Wall Street, Silicon Valley embraces reinvention. Most recently, it bounced back from defense

in 1995 in the form of its popular Navigator Web browser. Sun Microsystems Inc. has pulled off a similar coup with Internet Java software. In the same fashion, custom-chip companies such as Sun Logic still run circles around Intel when it comes to specialty chips. "Silicon Valley's distinct advantage is to create new markets," says Annalee Saxenian, a regional economist at the University of California at Berkeley and an expert on Silicon Valley.

The Valley—and the rest of the U.S.—must remain vigilant. Left unchecked, giants such as Intel and Microsoft could yet despoil the Valley's virtuous cycle if they become so successful that they either buy up or squeeze out too many small competitors. Such an outcome, while unlikely, would eventually foul the fertility of the region. Alternatively, a deep recession, combined with a big drop in the stock market, could kill off a lot of small companies and dry up the influx of capital.

And then there are earthquakes, floods, famines, and fire. But as long as innovation, diversity, reinvention, and sheer technological élan continue to infuse Silicon Valley, the hippest companies will find a way there—and the throng of elite will follow. Such is the power of mythic places—and right now, Silicon Valley is creating legends of its own.

By Michael J. Mandel in New York



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A WELLSPRING CALLED STANFORD

It built a community of technical scholars—and a world-class town-gown network

A panorama of fruit orchards greeted visitors to the southern San Francisco Bay area in the 1940s. Stanford University and the horse farms of its founder, Leland Stanford, formed the northern gateway to a valley tucked between two coastal mountain ranges and dotted with mission and train-stop towns such as Menlo Park, Palo Alto, Santa Clara, and San Jose. It was an

idyllic scene, with its mild climate, rolling hills, and agrarian pace.

But when a young, ambitious Stanford engineering dean, Frederick Emmons Terman, looked past the university's red tiled roofs, he saw raw opportunity. He had already helped a clutch of his best students, including Bill Hewlett and Dave Packard, start their own electronics companies. After

World War II, Terman knew the government was poised to begin an unprecedented investment in science and engineering. In that, he saw the potential to build a community of technical scholars to rival Oxford, Bologna, and other great centers of knowledge.

Terman, who died in 1982, would have loved what Silicon Valley has become. Part science lab, part industrial park, the Valley is a turbulent confluence of academic ardor, industrial intensity, unbridled imagination, and money. Flanked by Stanford, the University of California at Berkeley, and lesser

1993 Excite

Ben Lutch, Ryan McIntyre, Graham Spencer, Mark Van Haren, Joe Kraus, Martin Reinfried



1995 Yahoo!

Jerry Yang, David Filo

1981 Logitech

Pierluigi Zappacosta, Daniel Borel

1967 Asset Management Company

Franklin Johnson

1969 Mayfield Fund

Tommy Davis, Wally Davis

1974 Institutional Venture Associates

(now Inst. Venture Partners) Reid Dennis

1980 Technology Venture Investors

Burt McMurty, David Marquardt

STANFORD'S PROGENY



1982 Silicon Graphics

James Clark, six others



Its founder, a former Stanford assistant professor, took the high-performance road when he started the 3-D graphics company. Since then, many managers decided to strike out on their own.

1984 Cisco Systems

Leonard Bosack, Sandra Lerner



Founded by husband-and-wife Stanford staffers, Cisco is the No. 1 networking gear supplier.

1994 Healtheon

James Clark, two others



1994 Netscape

Marc Andreessen, James Clark

1995 NetGravity

John Danner

1995 Pietra

Way Ting, Shantanu Narayen, Ihab Abu-Hammad

1939 Hewlett-Packard

William Hewlett, David Packard



The company name was decided on a coin-toss in Packard's garage. Its success at developing measuring equipment and scientific instruments was more than luck of the draw, however. From its

first big sale of eight typewriters to Walt Disney for the movie *Fantasia*, the company would go on to produce calculators, computers, and printers. More significantly, it spawned a slew of other companies in telecom and computers (Tandem), cos (Altera, IDT), and other engineering-intensive fields.

1982 Sun Microsystems

Scott McNealy, Vinod Khosla, Andy Bechtolsheim



Made its name selling engineering workstations and

has since become a big player on the Internet of corporate networks. While management turnover has been fairly low, many who have left made it with startups such as Sun Microsystems.

1995 GolfWeb

Ed Pattermann, Cynthia Typaldos

1996 Marimba

Kim Polese, Arthur van Daele, Jonathan W. Samir Shalaby

1995 Granite Systems

Andy Bechtolsheim, David Cheriton



own engineering schools at Santa Clara University and San Jose State University, the Valley produces more graduates than any region in the S.—with over 4,100 engineering degrees in 1995.

Many alumni stay put and prosper. Between 1960 and 1990, companies started by Stanford graduates created over 250,000 jobs. Indeed, a family tree of Silicon Valley's origins shows a multi-generational, digital "begetting" of biblical proportions. "It's a network, as opposed to a hierarchy," says venture capitalist L. John Doerr of Kleiner Perkins Caufield & Byers. "And it's rooted in a terrific educational system."

IN SYSTEM. These days, Stanford engineering grad students aren't surprised an engineering professor Thomas Byers—brother of a prosperous venture capitalist—farms them out to local startups in midcourse to learn the meaning of entrepreneurship. Stanford faculty members are invited to address the "Entrepreneur Club," a regular meeting of local venture capitalists who drop by the student union to hear about the latest research. The dean of the Graduate School of Business, Michael Spence, sits on the board of Sun Microsystems Inc.



Stanford grads Dave Packard and Bill Hewlett greet Dean Terman in 1954

and is as fluent in routers and switches as in economic theory. "You are constantly bombarded [with technology] and so, almost by accident, you keep up to date," he says. "You actually end up right in the pushing and shoving,

and then at the margin, you're a customer, too."

Stanford's influence is immense. But it is just one template among many. Berkeley—whose alumni include both Gordon E. Moore and Andrew S. Grove of Intel Corp.—has its own character and strengths. Its style "has been to develop technology, convince existing companies to use the ideas, and then go back and develop more technology," says David A. Patterson, one of the school's prominent computer scientists.

Among the high-tech trends Berkeley scientists helped shape are relational databases, the most popular version of the UNIX operating system, and a speedy microprocessor architecture known as RISC, for reduced instruction-set computing. Some of these achievements sprang naturally from academic pursuits. And certainly the school has produced its share of superstars, including Sun Microsystems Vice-President of Research William Joy and Informix Corp.'s Roger Sippl, as well as legal power broker Larry W. Sonsini. But at Berkeley, many tech wizards stay in their academic robes, while at Stanford, "it's almost expected that a successful faculty member will at some

Im*
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an,
venster Jr.,
xfield

1974 Tandem Computers*

(now Compaq) Jim Treybig

1975 Megatest*

(now Teradyne)
Steve Bissett

1978 Trimble Navigation

Charles Trimble,
Kit Mura-smith,
Tom Coates,
Dan Babitch and
two others

1980 Lam Research

David Lam

1981 Pyramid Technology*

(now Siemens Pyramid)
Robert Ragan-Kelley,
Ed Dolinar, Al Gaynor

1983 Altera

James Sansbury, four others

1994 Integrated Device Technology

George Hwang, Frank Lee,
Chun Chiu

ple
s, Steve Wozniak
Jobs left Atari and
Wozniak left
Hewlett-Packard
companies turned
opportunity to
the Apple prototype.
ers encouraged an

almost religious fervor to make PCs for "the rest of us." Despite recent troubles at Apple, their crusade led to the development of other innovative computer hardware (NeXT, Radius) and software companies (Electronic Arts, Live World).

1972 Atari*

Nolan Bushnell

1977 Chuck E. Cheese's

Nolan Bushnell

1944 Ampex

Alexander M.
Poniatoff
Recording
industry
pioneer

Electronic Arts

ins, two others

NeXT

s

1986 Radius

Mike Boich, Burrell Smith,
Alain Rossmann, Andy Hertzfeld

1989 Echelon

Mike Markkula

1990 General Magic

Marc Porat, Andy
Hertzfeld, Bill Atkinson

1990 Be Inc.

Jean-Louis Gassée

1995 CyberGold

Nat Goldhaber

1996 Live World

Peter Friedman, Bernard
Bernstein, Jenna Woodul

1991 3DO

Trip Hawkins, Hugh Martin

1994 WebTV*

Steve Perlman, Phil Goldman, Bruce Leak (now Microsoft)

Industry Key



Venture Capital



Computers



Software



Internet



Networking



Games



Navigation



Chips



Telecom



Drives

point start a company," says Patterson.

The loyalty and affection alumni show their alma maters is part of the Silicon Valley perpetual motion machine. Silicon Graphics Inc., started by Stanford engineering professor James H. Clark, became a huge donor of money and equipment. Equally important, alums donate their personal time. Wilson Sonsini Goodrich & Rosati partner Sonsini and Mario M. Rosati, for example, both teach courses at Berkeley.

"NO LIMIT." David Kelley, the successful head of Palo Alto's IDEO industrial design firm, exemplifies what goes right in the Valley's academic/industry relations. When he's not running IDEO, he's helping to steer a product-design program at his alma mater, Stanford. "The reason I knock myself out and work two full-time jobs is I feel indebted to Stanford," says Kelley. Thanks to the school's

business-cum-science orientation, "I became a guy who made products instead of calculating brackets."

It seems like nobody does just one thing around here. Stanford's current engineering dean, John Hennessy, did pioneering computer-science work in RISC chips in the early 1980s. Then, Hennessy took a sabbatical, raised some venture capital, and founded MIPS Computing. He returned to Stanford in 1985. "The gap between research and what's in production," says Hennessy, "has narrowed to almost nothing."

For all his vision, Dean Terman might well have gaped at 1990s-style entrepreneurship. He could never have pictured Internet darling Yahoo! Inc., which started out in a grungy campus trailer in 1994, where electrical engineering grad students David Filo and Jerry Yang were bored to tears with

their PhD thesis. They began almost mindlessly making lists of their favorite Web sites. Rather than crack down on the digital goofing, the engineer school cut the pair slack.

Fast-forward two years to a hugely successful 1996 initial public offering and a time to return favors. Filo Yang, worth more than \$100 million apiece, became the youngest individual ever to endow a professorship in Stanford engineering school, with a gift of \$2 million. "As long as we maintain the practices that have made us who we are today," Terman wrote in a letter describing Silicon Valley's energy and success, "then there is no limit to the longevity of the situation."

Amen, say today's entrepreneurs rather, Yahoo!

By Joan O' C. Hamilton in Palo Alto with Linda Himmelstein in Menlo Park

1955 Shockley Labs*

William Shockley, eight others

Co-inventor of the transistor, Shockley recruited eight young men from East Coast labs to develop the technology. They left because of Shockley's erratic management style and became the founding cadre for the West Coast semiconductor industry.

1967 National Semiconductor

Charles Sporck, two others

After leaving Fairchild, Sporck ran National for 24 years, building it into a giant in analog and digital chips.

1981 Linear Technology

Robert Swanson, Robert Dobkin

1983 Sierra Semiconductor

James Diller, four others

1983 SDA Systems*

James Soloman

1957 Fairchild Semiconductor*

(From left) Gordon Moore, Sheldon Roberts, Eugene Kleiner, Robert Noyce, Victor Grinich, Julius Blank, Jean Hoerni, Jay Last

Founded by "The Traitorous Eight" from Shockley, Fairchild was the first company to work exclusively in silicon. It spawned more than 30 Silicon Valley companies, including Intel, Advanced Micro Devices, and National

1961 Signetics*

(now Philips Semiconductor) David Allison, David James, Lionel Kattner, Mark Weissenstern, two others

1985 Cirrus Logic

Michael Hackworth, Kamran Elahian, five others

1993 NeoMagic

Kamran Elahian, Prakash Agarwal

1996 Planet Web

Kamran Elahian

1979 VLSI Technology

Jack Baletto, Dan Floyd, Gunnar Wetlesen

1983 Wafer Scale Integration

Eli Harari

FAIRCHILD'S OFFSPRING



1968 Computer Microtechnology*

John Schroeder, Jack Schmidt, two others

1973 Synertek*

Robert Schreiner, R. Barringer, six others

1968 Intel

Robert Noyce, Gordon Moore

The king of PC microprocessors, Intel is now the largest chip company in the world, with revenues topping \$20 billion. Most Intel execs stay on board instead of launching startups.

1974 Zilog*

Federico Faggin, Ralph Ungermann

1984 Xilinx

Bernard Vonderschmitt

1986 Synaptics

Federico Faggin, Carver Mead

1969 Four Phase*

Lee Boysel, Jack Faith

1972 Kleiner Perkins

Eugene Kleiner

1980 LSI Logic

Wilfred Corrigan

1969 AMD

W.J. Sanders III, seven others
Flamboyant Sanders left Fairchild to found this up-and-down rival to Intel. Its swing is up right now.

1983 Cypress

T. J. Rodgers, Lowell Turfitt

1981 SEEQ

Gordon Campbell, George Perlegos

1985 Chips & Technologies*

Gordon Campbell, Dado Banatao, two others

1989 S3

Ron Yara, Dado Banatao

1985 Atmel

George Perlegos, Tsung-Ching Chang

1994 3Dfx

Gordon Campbell, Scott Sellers

THE LONG SHADOW OF BILL GATES

Valley executives can't forget for a second who's the guy to beat

Microsoft Chairman William H. Gates III doesn't get down to Silicon Valley all that often—which could be a good thing. After all, this is his territory. One Valley competitor made gifts of golf balls with a photo of Gates on them, inviting people to throw a whack. And a columnist for a hometown newspaper recently dubbed him the “Prince of Darkness.” Funny, yes. But there's a raw edge to this rivalry. Silicon Valley can be celebrated as the cradle of American innovation, but its executives don't forget for a second that Microsoft Corp. dominates the world of personal-computer software. It was Microsoft's Windows software—going with Intel Corp.'s chips—provided a standard for thousands of PC makers and software developers to build upon. And whether or not, many find themselves tied to the software giant.

Still, the might of Microsoft is a constant to the very tenet of the Valley: If one company dominates, the best ideas—among companies—may not bubble to the surface. Gary L. Reback, with the law firm Wilson, Sonsini, Goodrich & Rosati, says the Valley is like a popcorn popper: Throw in a bunch of entrepreneurs, add venture capital, and watch it explode. If one company rules, he argues, innovation is squelched. Adds James H. Clark, chairman of Netscape Communications Corp.: “Microsoft, I think, is fundamentally an evil company.”

“KILLING EFFECT.” You know the back-and-forth. Microsoft has capitalized on its success with Windows—which now sits on about 90% of PCs—to wage war against its software rivals. While Microsoft reaped \$3.45 billion in profits in its just-ended fiscal year, the next largest PC-software makers com-



bined posted just \$523 million in operating profits.

What really ticks Valley-ites off is when Microsoft rubs it in. Last August, Microsoft execs met with about 50 Valley venture capitalists and advised them not to sink money into startups that challenge its control of the computing “platform,” according to L. John Doerr of Kleiner Perkins Caufield & Byers, which has backed rival Netscape. Reback, who has represented several software firms in court cases against Microsoft, says those tactics have “a chilling effect.”

Thanks to the Internet, Reback's bleak warning doesn't resonate like it did just two years ago. The Web has spawned a new crop of startups undaunted by Microsoft's long shadow.

“People who don't know how to compete with Microsoft feel threatened. People who know how to compete, don't,” says Mike Homer, Netscape's executive vice-president for sales and marketing.

GANGING UP. Homer can back up his bravado with numbers. In just three years, Netscape has lined up 65 million customers and is on track to log sales of \$600 million this year. Still, the company is racing to stay ahead of Microsoft, which has already grabbed 30% of the browser market that Netscape pioneered.

Indeed, taking on Microsoft is a job too big for any one company, spurring Netscape, Sun Microsystems, Oracle, and IBM to form a united front against their common foe. Their weapon: Java. Sun's programming language promises to let developers create programs that will run on any computer and, potentially, lessen their dependence on Microsoft. “Microsoft is feared and loathed, and that drives companies together against them,” says George Paolini, director of corporate marketing for Sun's JavaSoft Div.

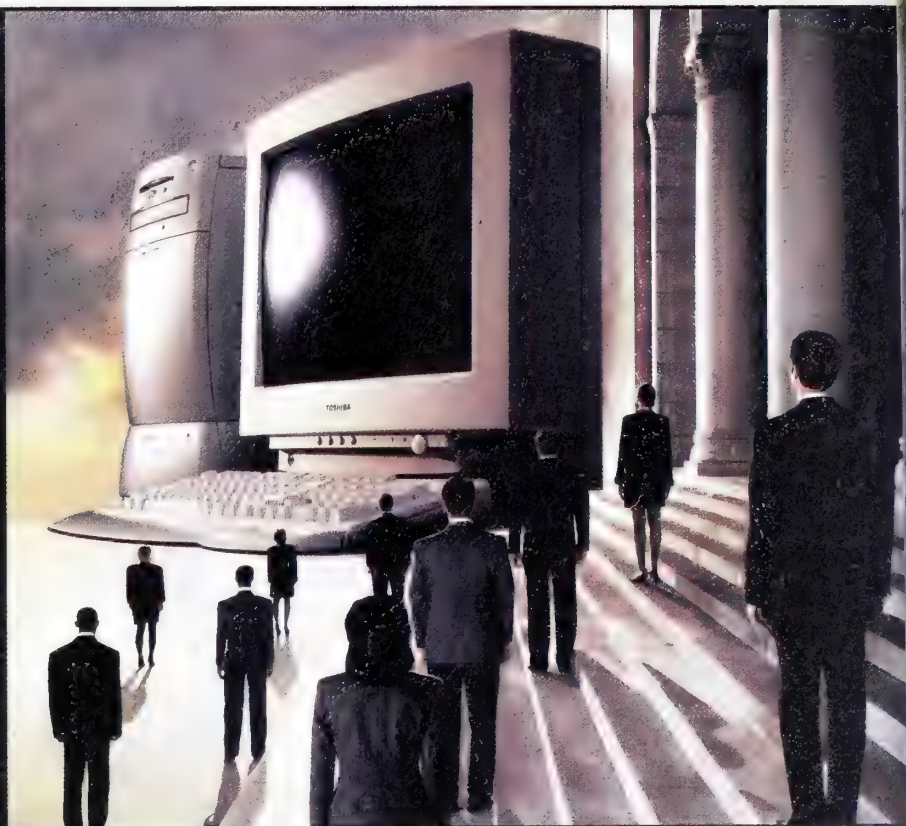
Not all companies are willing to take the risk of offending Gates. Most rely on Microsoft's support in developing products for Windows. And picking a fight with Microsoft can be a fast track to oblivion. So the majority of Silicon Valley companies maintain cordial relations with their neighbor to the north. Even Borland International Inc., which in May sued Microsoft, alleging it stole some of its best programmers, retains close ties with the Redmond (Wash.) software giant.

Microsoft is quick to point out that its 320 resellers and partners in Northern California made \$16 billion in Microsoft-related sales last year. And it shrugs off criticism. “We compete hard, but we compete fairly,” says Charles Dietrick, Microsoft's manager for Northern California. Even small partners can get kid-glove treatment. Tiny Sessionware Inc. of Campbell, Calif., paid \$2,000 last year to be part of Microsoft's service-provider program—but got \$10,000 back for training.

That's winning Microsoft some fans. Rand Morimoto, president of systems integrator Inacom Oakland, even posted a snapshot of Gates on his Web site. The way he sees it, the Valley has a love/hate relationship with Gates. “With Windows, Microsoft has everybody in shackles,” he says. “But, at the same time, it drives a big part of the business here.” As long as that's true, when Gates comes south for a visit, most people are likely to grin and bear it.

By Steve Hamm in San Mateo

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THE TOP 5 POWER BROKERS

an all name some of the most powerful le in Silicon Valley—Intel's Andy e, Apple co-founder Steve Jobs, and Sun osystems' Scott McNealy. But who are ringmakers behind the throne? Who s the cogs well-oiled with the essentials: lealmaking, the rich flow of capital, and onnections to nurture the next cape? Here's a look at the top 25 behind-scenes power brokers. For more on up-comers, see www.businessweek.com



CHARLES FEDERMAN, 40

Chairman, Broadview Associates
erman's Broadview a hand in over 20 n acquisitions th some \$2 billion year, making it of Silicon Valley's mergers-and-acqui- ns firms. He han- s big deals, such as viett-Packard's buy- of VeriFone, but cializes in small-fry over candidates.

JOHN ARRILLAGA, 60

Partner, Peery/Arrillaga
As dealmaker for one of the area's top landowners, the secretive developer calls the shots when it comes to doling out precious office space. Normally, he only provides facilities to companies that can pay cash. But if Arrillaga senses a winner, as he did when Sun Microsystems and Quantum were startups, he gives lenient terms—and then collects rents as they grow.

DANIEL H. CASE III, 40

President and CEO, Hambrecht & Quist
Since Case took the helm of H&Q in 1994, the former Rhodes Scholar has presided over a frenzied period of growth for the San



JOHN DOERR, 46

➤ **Partner at Kleiner Perkins Caufield & Byers**
Dubbed the "human hummingbird" for his flitting among industry moguls, Doerr is perhaps the biggest power broker in Silicon Valley. He has financed such highfliers as Sun Microsystems, Netscape, and Compaq, and hob-nobs with Clinton.

Francisco investment-banking boutique. H&Q has co-managed a series of high-profile initial public stock offerings, including Netscape and Amazon.com. And now it's beefing up after raising \$64 million in its own IPO. Still, as the only remaining independent San Francisco-based investment bank, H&Q must grapple with constant takeover rumors.

JOHN C. DEAN, 49

CEO, Silicon Valley Bank
Once they have a check from a venture capitalist, many entre-

preneurs proceed directly to Silicon Valley Bank to open a bank account and help in setting up an accounting system. That puts Dean, who came to the Valley five years

ago, at the center of the startup action.

JOHN C. FRY, 40

President, Fry's Electronics Inc.
Son of a grocery magnate, this publicity-

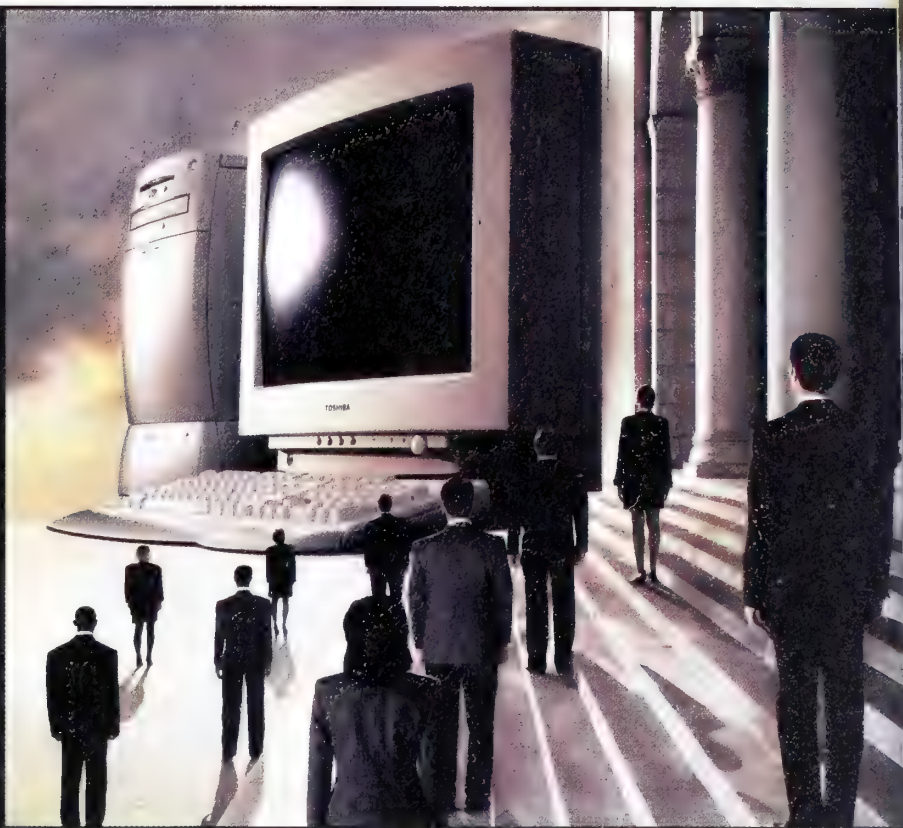


ANN WINBLAD, 46

➤ **Partner, Hummer Winblad Venture Partners**

One of the few venture capitalists to invest only in software, she spotted winners Powersoft, Arbor Software, and Wind River Systems. Her technique: mega-networking. She's at industry events some four nights a week and often vacations a week each year with pal Bill Gates.

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shy retailer who controls the most precious shelf space in Silicon Valley. Selling everything from computer chips to potato chips, Fry's is where engineers get the gear to build prototypes—and companies find

has been in office since 1991, she has simplified the building-permit process and cut deals to bring giants such as Adobe and Netcom to San Jose. One of her tricks for developing business ties: monthly



ROGER McNAMEE, 41

► Partner, Integral Capital Partners

He made his name as a manager of T. Rowe Price Science & Technology Fund and now runs a Kleiner Perkins spin-off, investing in public and private companies. The No. 1 industry networker, he chats up CEOs and engineers alike, making him a sharp tech investor.

out if their latest wares have a chance of hitting it big. Sales should hit \$1.2 billion in 1997.

J. WILLIAM GURLEY, 31

Partner, Hummer Winblad Venture Partners
Two weeks after joining Credit Suisse First Boston as a cub stock analyst in 1993, Gurley talked his way onto the hot PC beat—and got a reputation for incisive analysis of Dell Computer, Apple, and others. As Internet guru for Deutsche Morgan Grenfell in 1996, his analysis once triggered a \$10 drop in Netscape shares. Now, he'll do the investing as a venture capitalist.

SUSAN W. HAMMER, 58

Mayor of San Jose
If there's any threat to Silicon Valley's tech domination, it's the increasing cost of office space. But Hammer is working on the problem. An unabashed industry backer who

CRAIG W. JOHNSON, 50

Chairman, Venture Law Group
The former No. 2 at premier law firm Wilson Sonsini, he founded VLG in 1993 to cater to entrepreneurs—who typically trade a small equity stake in exchange for legal advice and business smarts from VLG's 60 lawyers. Clients include Yahoo!, WebTV, and others that appreciate Johnson's real-world approach: besides a no-tie dress code, VLG's lawyers don't indulge in legalese.

G. RICHARD KRAMLICH, 62

Managing Partner, New Enterprise Associates
Kramlich has been a fixture of the Valley scene for more than 25 years. His venture-capital firm, having invested in such biggies



JOHN L. HENNESSY, 44

► Dean, Stanford's School of Engineering

He helps set the Valley's research agenda by recruiting Stanford's electrical engineering and computer science faculty. No ivory-tower academic, he took a sabbatical in 1984 to commercialize his leading-edge research in RISC chips. That led to the creation of MIPS Computer.

as Ascend Communications, Bay Networks, and 3Com, has one of the top records for companies going public—about one a month for the past 6½ years. NEA's success has enabled Kramlich to become one of the country's leading collectors of multimedia art.

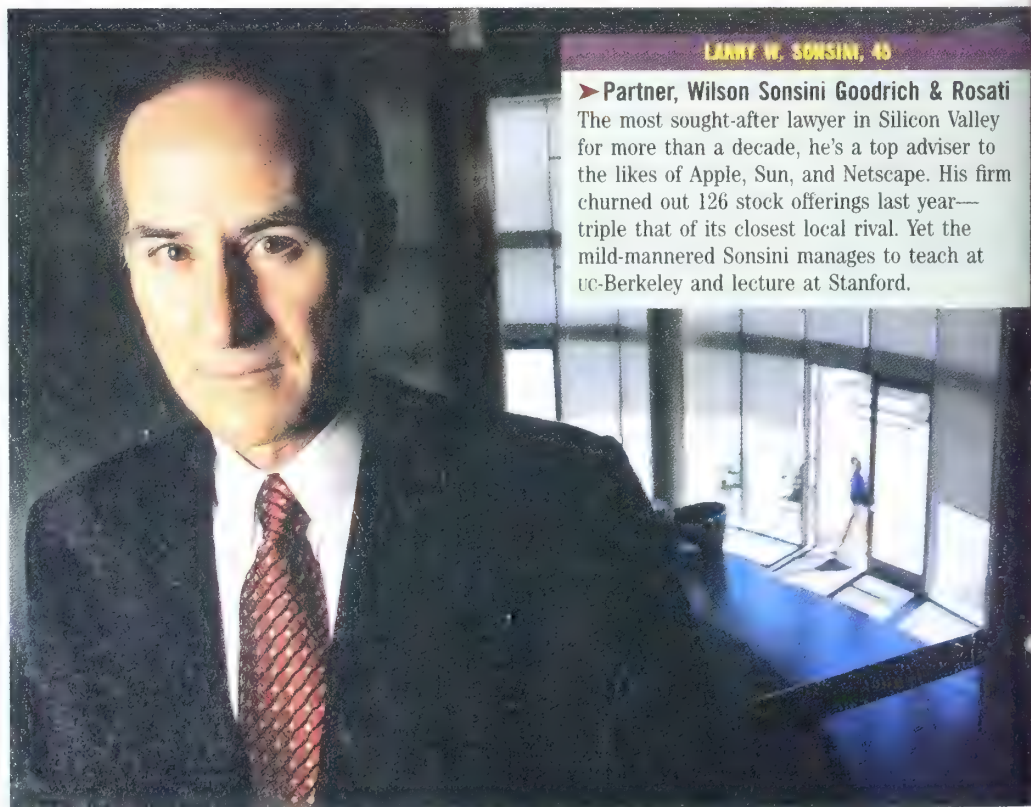
DAVID F. MARQUARDT, 48

Partner, August Capital
A Microsoft board member, he's William

H. Gates III's most visible representative in the Valley. That and his astute investment record—he helped finance Sun Microsystems and Compaq Computer—have made him a sought-after venture capitalist with his \$100 million fund.

REGIS McKENNA, 57

Chairman, McKenna Group
The legendary image maker behind Apple



LARRY W. SONSINI, 43

► Partner, Wilson Sonsini Goodrich & Rosati

The most sought-after lawyer in Silicon Valley for more than a decade, he's a top adviser to the likes of Apple, Sun, and Netscape. His firm churned out 126 stock offerings last year—triple that of its closest local rival. Yet the mild-mannered Sonsini manages to teach at UC-Berkeley and lecture at Stanford.

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DAVID L. BEIRNE, 33

► **Chairman, Ramsey/Beirne Associates
Partner, Benchmark Capital**

This tireless, 6-ft. 7-in. headhunter gets the first crack at many high-profile CEO searches. Now he'll search for talent to run Benchmark-funded firms.



Computer and Intel, McKenna is the granddaddy of high-tech marketing. Now, when he's not penning books or advising tech companies, he sits on a half-dozen boards. He's also hosted the Clintons at his home.

BECKY MORGAN, 58

President and CEO, Joint Venture: Silicon Valley Network
As head of this partnership of 200 Valley businesses and 25 local governments, the former California state senator spearheads



JOHN E. WARNOCK, 58

► **CEO and Chairman, Adobe Systems**

Adobe's chief is at the vanguard of a new trend: corporate venture investing. He created Adobe Ventures in 1993, an \$80 million fund with stakes in Siebel Systems and Web "zine" Salon Internet. This gives Warnock, who sees 50 deals a week, a peek at new technologies.

such efforts as streamlining government paperwork and getting local schools Internet access. Her husband,

James C. Morgan, is the CEO of chip equipment maker Applied Materials, making them a true Silicon Valley power couple.

MASAYOSHI SON, 39

CEO, Softbank Corp.
Worth about \$3.5 billion, Korean-born Son, who lives in Japan, is enroute to creating a multimedia conglomerate for the Internet Age. The top publisher of computer-related magazines, such as *PC Week*, he also controls the huge Comdex industry trade show and has investments

worth \$350 million in some 50 Net startups, including Valley-ites Yahoo! and usweb.

JOHN T. THOMPSON, 49

Vice-chairman, Heidrick & Struggles
Top dog in Silicon Valley for high tech's key headhunting firm, he is the one that troubled companies call to find that executive savior. He zeroed in on Raymond J. Lane to be Oracle's president and Brian L. Halla for National Semiconductor.
Thompson's latest job may be the toughest: finding a replacement for Gilbert F. Amelio, who was ousted as CEO of Apple Computer in early July.

DONALD VALENTINE, 65

General partner, Sequoia Capital
He's known for being the matchmaker between Steven Jobs and A. C. "Mike" Markkula, who helped bankroll Apple. But Valentine has had

many major-league hits—Cisco and Yahoo! He is slowly handing Sequoia's reins over to young partners but is still respected for his hard-nosed investment philosophy, which is rare in this hype-heavy industry.

LESLIE L. VADASZ, 60

Director of business development and government relations, Intel Corp.
Intel's No. 3 employee and a member of the board, Vadasz wielded behind-the-scenes power as manager of the company's \$500 million investment war chest. With equity stakes in some 10 companies, including CyberCash and CNE, Intel is in the same league as the Valley's top venture funds. He also hobnobs with D policy types for Intel.



FRANK QUATTRONE, 41

► **CEO, Deutsche Morgan Grenfell Technology Group**

Quattrone made Morgan Stanley one of tech's top investment banks by taking companies like Netscape public. Now he's out to do the same at DMG Deutsche Bank's 16-month-old tech group. He has already raised \$54 million with the IPO of online bookseller Amazon.com.



SANFORD ROBERTSON, 45

► **Chairman, Robertson, Stephens**

A Valley elder statesman, Robertson recently fetched \$540 million from BankAmerica for his tech investment bank. Not bad, but then he backed such hits as Steve Jobs's Pixar Animation Studios and online broker E*Trade. He also moves in Clinton circles.



**Your business
isn't something
you should
entrust
to people who
think small.**

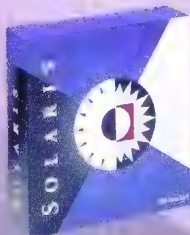
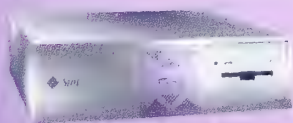
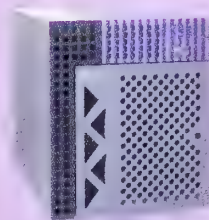
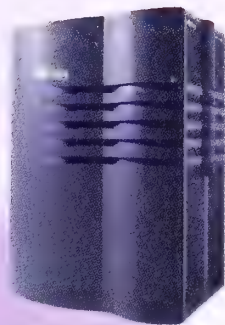
To build, you need a grand plan.

At Sun, we look at the big picture, from the enterprise down. Not from the personal operating system up. For over fifteen years we've been developing and refining technologies to meet the global demands of some of the world's most successful businesses. Our vision of network computing is enabling innovation at companies like BT, Eastman Kodak, FedEx, Mastercard, Nortel (Northern Telecom), Nova Scotia Power, Pfizer Inc., The Gap, and Volvo. Allowing them to push the frontiers of worldwide data access, streamline internal operations, create new revenue streams, and build closer customer relationships. Taking them into a future of unlimited growth with Java.™ And giving them, with systems designed from the ground up for network computing, the means to create real competitive advantages. No other computer company is doing this. No other computer company can



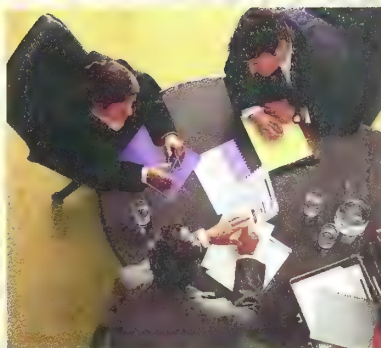
To expand, you need powerful tools.

Network computing without scalability just doesn't compute. That's why, at Sun, we've developed a complete range of scalable servers and storage systems, with seamless integration from PCs to the desktop to global computer environments. A single Sun system can manage an entire enterprise, providing superior price/performance, uptime, and reliability. Our end-to-end security allows you to confidently run your decision-support, resource planning, and intranet applications. Our Solaris operating environment runs large-scale applications better than any other platform, accommodating one to thousands of users. And our Java™ computing technologies offer a smooth transition to open computing in the next millennium. Network computing without limitations. That's why all those global companies are growing with Sun. And that's why you should, too.



**To grow,
you need the
right support.**

Get the best out of enterprise network computing with services from Sun. Nobody else knows it as well as we do. Our multi-talented, multi-discipline experts plan, implement, and manage everything from simple workgroups to global network computing environments. Witness the way we helped guide the FedEx migration to global distributed computing. Designed Pfizer's worldwide research network. Gave Eastman Kodak an education in Java technology. And continue to support BT's critical service management systems. With our "nothing is impossible" attitude, we're helping to bring out the best in some of the world's most dynamic companies. We can do the same for you.





To succeed,
you need Sun.

We have the plan, the products, the people. We have over fifteen years of focused enterprise network computing experience. We offer proven technologies, global solutions, and clear competitive advantages. We offer you a future without limits. If that's what you're looking for, look no further. We're here. **THE NETWORK IS THE COMPUTER™**



STARTING UP AGAIN— AND AGAIN AND AGAIN

Sticking while you're ahead is an alien concept to most Valley entrepreneurs

For most of America, long-term job security died in the early 1990s on the altar of corporate downsizing. In Silicon Valley, security was never an issue. Chucking your job—to start a new company—has always been a rite of passage. “It’s part of the culture here,” says John W. 3, partner at Menlo Ventures in Palo Alto.

For status seekers just can’t get enough. Their ladder-climbing has created an elite subculture of serial entrepreneurs, including two dozen individuals you might call “three-timers”—all with three or more startups to their credit. Woodside resident Gene M. Amdahl tops the list with more than 20 to his name, though most of his ventures were transplanted out of Silicon Valley. Others, such as computer genius Gene M. Amdahl and Raytheon Corp. founder Paul M. Cook are past retirement age. There’s even a few as wedded to starting companies as they are to each other (page 102).

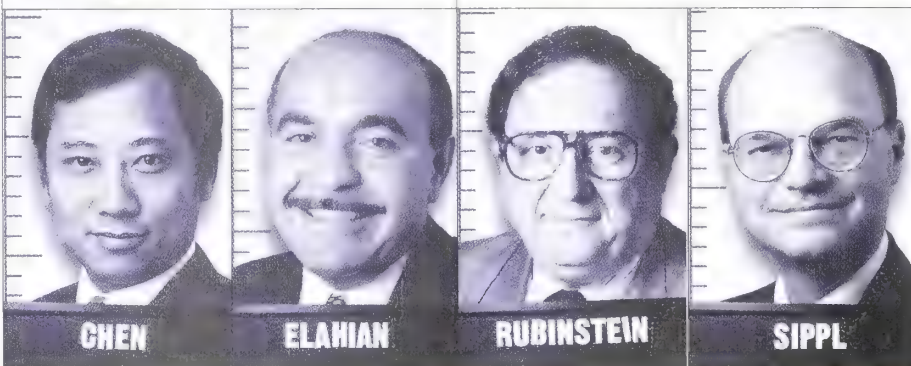
These repeat entrepreneurs amaze even Sam A. Sahlman, a Harvard business school professor who tracks their adventures. “It’s a rare, rare person who has the ability to do two things successfully,” he says. Sahlman notes, venture capitalists score big about 15% of the time. The success rate for repeaters might be double that, he says, “it’s not 80%.” At Bushnell’s average is under 50%.

AT FEELING. What drives these devils to take the risk? Different reasons, but money isn’t the primary motivation, says Pehong Chen. Born in Taiwan in 1957, he founded Gain Technology Inc. in 1989 with \$4,000 and a few years later sold the multimedia software house for \$100 million. “I realized to retire, but after three years, I got restless,” he says. So he started Siebel Systems Inc., a provider of sales-automation software. To-

day, he dotes on BroadVision Inc. and its personalized Internet shopping system. “I need to create stuff: new technology, new solutions, new companies. It’s a great feeling you can’t get any other way.”

Most serial entrepreneurs second those sentiments. Says 40-year-old Steven T. Kirsch, who attained three-peater status in 1994 with Infoseek Corp.: “You’re doing something significant—changing the world and making it a better place.” L. Curtis Widdoes Jr., 45, gets his kicks from “working with good people” and creating innovative products. “The easiest path to that is starting a new company,” he says. Last year, he founded his third, O-In Design Automation Inc.

Baby No. 3 for Roger J. Sippl is Visigenic Software Inc. His 17% stake is worth \$25 million, and two venture-capital investments netted \$11 million on top of his previous startups. So piling up personal wealth “isn’t really important anymore,” he says. “At some point, you decide how much you’re going to leave your children, and the rest goes to charity.” Sippl, 42, figures he’ll donate most of his future earnings to



Serial Entrepreneurs: Once Is Never Enough

ENTREPRENEUR, AGE

COMPANIES FOUNDED (STARTUP DATE)

GENE M. AMDAHL, 77

Amdahl Corp. (1970), Trilogy Ltd. (1980), Commercial Data Servers Inc. (1994)

GORDON A. CAMPBELL, 53

Seeq Technology Inc. (1981), Chips & Technologies Inc. (1984), 3Dfx Interactive Inc. (1994)

PEHONG CHEN, 40

Gain Technology Inc. (1989), Siebel Systems Inc. (1993), BroadVision Inc. (1993)

KAMRAN ELAHIAN, 42

CAE Systems Inc. (1981), Cirrus Logic Inc. (1984), Momena Corp. (1989), NeoMagic Corp. (1993), PlanetWeb Inc. (1996), Centillum Technology (1997)

STEVEN T. KIRSCH, 40

Mouse Systems Corp. (1982), Frame Technology Corp. (1986), InfoSeek Corp. (1994)

D. T. “TOM” MITCHELL, 55

Seagate Technology Inc. (1979), Conner Peripherals Inc. (1986), JTS Corp. (1994)

SEYMOUR I. RUBINSTEIN, 63

MicroPro International Inc. (1978), Surpass Software Systems (1987), Prompt Software Inc. (1995)

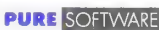
ROGER J. SIPPL, 42

Informix Software Inc. (1980), Vantive Corp. (1990), Visigenic Software Inc. (1993)

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Leadership in Technology M&A

 <i>has acquired</i> Tandem Computers Incorporated <i>January</i>	 <i>has acquired</i> ParaGraph International <i>January</i>	 <i>has acquired</i> Samsung Electronics Co. <i>December</i>	 <i>has agreed to be acquired by</i> Science Applications International Corporation (SAIC) <i>January</i>	 <i>has acquired the Reserch Network Division of</i> Intelligent Electronics Inc. <i>January 1997</i>	 <i>has sold its Defense Electronics business to</i> Raytheon Company <i>July 1, 1997</i>
 <i>has acquired</i>  Ascend <i>January</i>	 <i>has been acquired by</i>  Compaq <i>January 1997</i>	 <i>has acquired</i> VeriFone, Inc. <i>January 1997</i>	 <i>has acquired</i>  3Com <i>January 1997</i>	 <i>has acquired</i> Nexion <i>an acquisition of</i> Ascom Holding A.G. <i>January 1997</i>	 <i>has merged with</i>  Synopsys <i>March 1, 1997</i>
 <i>has acquired</i> Persel Holdings Ltd. <i>January</i>	 <i>has acquired</i> Sahara, Inc. <i>January 1997</i>	 <i>has acquired</i> Opal, Inc. <i>an acquisition of</i> Orbit Instruments Ltd. <i>January 1997</i>	 <i>has acquired</i> Modem Media <i>December 1996</i>	 <i>has acquired</i> NCR Corporation <i>December 11, 1996</i>	 <i>has sold its Aerospace and Defense Business to</i> Boeing Company <i>December 9, 1996</i>
 Dun & Bradstreet Software Services, Inc. <i>has acquired</i> Geac Computer Corporation Ltd. <i>November 1996</i>	 <i>has acquired</i> Atria Software, Inc. <i>November 1996</i>	 <i>has sold</i> AT&T Paradyne <i>to</i> Texas Pacific Group <i>November 1996</i>	 <i>has acquired</i> Holistic Systems, Ltd. <i>June 18, 1996</i>	 <i>has acquired</i> InSoft, Inc. <i>April 1, 1996</i>	 <i>has acquired</i> Armon Networking Ltd. <i>April 1996</i>
 <i>has acquired</i> Tivoli Systems, Inc. <i>January</i>	 <i>has sold its Business Applications Division</i> Corel Corporation <i>January</i>	 <i>has acquired</i> Illustra Information Technologies, Inc. <i>February 1, 1997</i>	 <i>has acquired</i> Conner Peripherals, Inc. <i>February 1, 1997</i>	 <i>has acquired</i> NetWorth Corporation <i>December 1, 1997</i>	 <i>has acquired</i> Frame Technology Corporation <i>October 2, 1997</i>

MORGAN STANLEY DEAN WITTER

Leadership in Technology IPOs

 HomeNetwork \$108,675,000 Common Stock July 19, 1997	 Rambus Inc. \$37,950,000 Common Stock May 15, 1997	 NEOMAGIC TECHNOLOGIES \$11,400,000 Common Stock March 1, 1997	 TMP Worldwide \$67,200,000 Common Stock December 12, 1996	 Magma Design \$199,500,000 Common Stock December 11, 1996	 SEA CHANGE INTERNATIONAL \$34,500,000 Common Stock November 1, 1996
 INGRAM MICRO \$414,000,000 Class A Common Stock October 31, 1996	 M7 \$129,375,000 Initial Public Offering September 20, 1996 \$88,500,000 Common Stock February 14, 1997	 CYMER \$36,489,500 Initial Public Offering September 18, 1996 \$87,150,000 Common Stock December 12, 1996	 I.N.S. INTERNATIONAL NETWORK SERVICES \$46,000,000 Common Stock September 18, 1996	 Fusion Systems \$103,718,500 Initial Public Offering January 3, 1996 \$142,600,000 Common Stock October 31, 1996	 cnet \$32,000,000 Common Stock July 1, 1996
 DASSAULT SYSTEMES \$179,686,235 Common Stock in the form of Shares or ADRs June 27, 1996	 DUPONT PHOTOMASKS, INC. \$78,200,000 Common Stock June 1, 1996	 VIA \$125,580,000 Initial Public Offering March 11, 1996 \$273,700,000 Common Stock March 1, 1997	 FORTE \$51,922,500 Common Stock March 11, 1996	 DOCUMENTUM \$49,680,000 Common Stock February 1, 1996	 \$33,125,000 Initial Public Offering November 1, 1995 \$86,250,000 Common Stock November 1, 1996

Leadership in Technology Financings

 Data General \$185,000,000 Convertible Subordinated Notes* May 15, 1997	 EMC Corporation \$450,000,000 Convertible Notes* March 6, 1997	 Seagate \$700,000,000 Senior Notes and Debentures February 1, 1997	 ORACLE \$300,000,000 Senior Notes February 19, 1997	 IMS Integrated Measurement Systems, Inc. \$34,237,500 Common Stock February 1, 1997	 SAP \$348,431,028 Non-Voting Preference Shares August 1, 1996 \$526,400,000 Common Shares February 6, 1997
 ASML ASML Lithography \$268,106,250 Ordinary Shares* January 29, 1997	 LEXMARK \$248,750,000 Class A Common Stock January 29, 1997	 MXIC Macronix International Co., Ltd. \$200,000,000 Convertible Bonds January 1, 1997	 ARROW ELECTRONICS, INC. \$100,000,000 Senior Notes and Debentures January 16, 1997	 \$189,000,000 Integral Capital Partners III, L.P. January 1, 1997	
 MICROSOFT \$1,000,000,015 Convertible Exchangeable Principal-Protected Preferred Shares December 17, 1996	 CADENCE \$210,737,500 Common Stock November 21, 1996	 VeriSign \$29,000,000 Private Placement of Preferred Stock November 18, 1996	 Nortel \$346,150,000 Common Stock November 11, 1996	 ZORBERG \$48,360,000 Common Stock October 1, 1996	 PointCast \$36,000,000 Private Placement of Preferred Stock July 1, 1996
 TEXAS INSTRUMENTS \$400,000,000 Senior Notes July 24, 1996	 EOS \$932,500,000 Common Shares July 16, 1996	 Apple Computer, Inc. \$661,250,000 Convertible Subordinated Notes January 1, 1996	 Lattice Lattice Semiconductor Corporation \$91,562,500 Common Stock November 1, 1996	 VILINK \$250,000,000 Convertible Subordinated Notes November 7, 1995	 SGS-THOMSON \$900,450,000 Common Shares November 1, 1996

CLOSE UP

Love Among The Digerati

No matter how commonplace entrepreneurs become, husband-wife teams will always be rare. The stress is just too intense. That's why Silicon Valley is toasting Judith L. Estrin and William N. Carrico, whose marriage has survived not one startup, but three.



Their first venture was Bridge Communications Inc., a networking company founded in 1981. By 1987, when 3Com Corp. acquired it for \$235 million in stock, Bridge was raking in \$70 million a year. Next, in 1988, they started Network Computing Devices Inc.—which makes exactly that. The couple took it to \$140 million in sales in 1995, then left to found Precept Software Inc. Last year, Precept shipped about \$1 million worth of “multicasting” software for putting real-time video on corporate networks.

The couple's business relationship started in 1979 at chipmaker Zilog Inc. After co-founder Ralph Ungermann left to form Ungermann-Bass Inc., Estrin was promoted to engineering manager of the systems division. Carrico was recruited to help turn the unit around, and the pair collaborated on a networking project called Z-Net. It flopped, but a ro-

mance blossomed as they hashed out plans for Bridge, and in 1987 they tied the knot.

Often dubbed the Bill & Judy Show, the duo blends a Mrs. Outside, Mr. Inside set of personalities. “I’m the people person,” says Estrin, who’s president of Precept and

thrives on dealing with customers. Chairman Carrico is the strategist but gets involved in operations “when aggressive action is called for”—at which point, the preferred moniker is “Punch & Judy.”

REBOUNDS. Joint entrepreneurship can also shred a marriage. Sandra Lerner founded Cisco Systems Inc. in 1984 with her husband, Leonard Bosack. By 1990, each had amassed about \$100 million in stock, but their marriage was on the rocks. Lerner blames “years of overwork, under-money, and having to make all decisions for the benefit of the company, not the marriage.” After an amicable divorce, Bosack founded XKL Systems Corp. in 1991, while

Lerner launched Urban Decay, a cosmetics firm, in 1995.

Married or divorced, starting up companies seems to get easier with practice. It’s a matter of having the contacts, knowing the pitfalls, and nabbing the capital. Judy Estrin says funding her first company took six months “and countless presentations.” For No. 2, NCD, two phone calls landed \$5 million in minutes. When word of Precept’s founding got out in March, 1995, Estrin says: “We had venture capitalists calling us and begging us to take their money.” When it comes time for No. 4, the phones will probably ring again.

By Otis Port in San Mateo

Stanford University and can research.

For some, there’s a need to prove the first success was no fluke. Seymour Rubinstein, 63, formed MicroPro International Inc. in 1978 with \$8,500 and launched WordStar, the best-selling word processor of the 1980s. He tried to repeat in 1987 with QuattroPro spreadsheet program developed by startup, Surpassed Software Inc., but fell short. “I’m still searching for a vana,” he says. His latest shot: two-year-old Prompt Software Inc., which sells search engine called WebSleuth.

Kamran Elahian admits he was “hungry” after starting his first company, CAE Systems Inc., in 1981 at the age of 27. In 1984, Tektronix Inc. bought CAE for \$75 million, but Elahian’s investors took the lion’s share, leaving him with only a few million. So he launched chipmaker Cirrus Logic Inc. It went public in 1989, valued at \$1 million. Sure he had the Midas touch, Elahian took on computers with Menta Corp. in 1989. Splat. “Investors threw \$40 million at us,” he laments. “We lost it all in three years.”

SHORT MEMORIES. Fortunately Elahian, the Valley deems failure is only inevitable but valuable. After limping his wounds for 10 months, the Iranian-born entrepreneur had no trouble raising \$11 million to start NeoMagic Corp., another chip company. Michael Moritz, a partner at Sequoia Capital, put up \$3 million, noting that entrepreneurs who have suffered a setback can be better bets than those who have only enjoyed success. NeoMagic paid off by going public last March with a valuation of \$300 million. Says Elahian: “All my sins were forgiven.”

Elahian, like Sippl, wants to give something back. In May, 1996, he started Project NEAT, a nonprofit push to bring Internet access to small schools in remote areas of the globe. It’s linked to a for-profit venture called PlanetWeb Inc., which markets software that turns video game machines and settop boxes into low-cost Net terminals. Elahian installed PlanetWeb systems in 1,000 schools last year and has vowed to put them in 10,000 this year.

Of course, kids around the world will also want to chat with one another on the Net, in living color. Finding a cheap way to do that is a job for startup No. 6, five-month-old Centillum Technology. In the world of serial entrepreneurs, second chances can become a habit. And the only unforgivable sin is never to try in the first place.

By Otis Port in San Mateo



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Rule two: don't spend a lot.*

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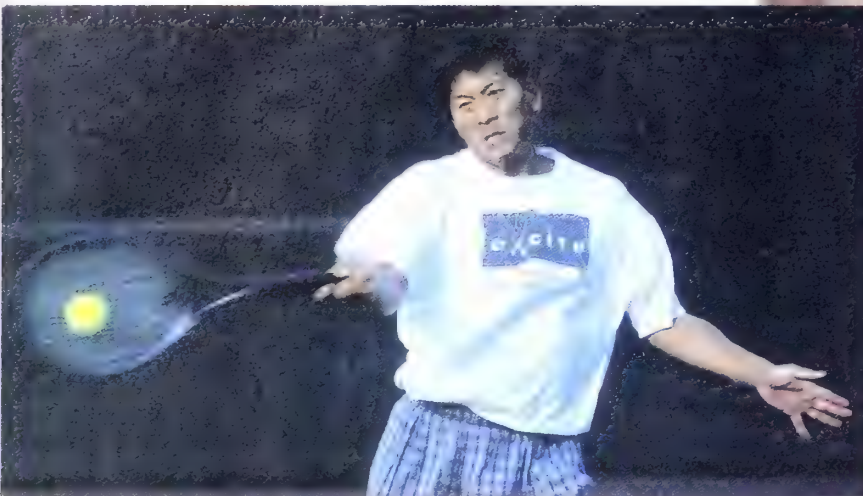






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Venture capital never sleeps



THE WARM-UP Yang starts jamming with an early morning tennis match against a realtor who helps find office space for startups. By 8:20 a.m., he's on the move, racing to the first in a series of meetings

THE GREAT HUNT FOR HOT IDEAS

What starts with a bagel may end with another Yahoo!

The art of the deal begins, in Palo Alto, Calif., with breakfast at Hobee's. By 7:30 a.m., Geoffrey Y. Yang, a 38-year-old venture capitalist, has settled into his table, this morning with entrepreneur Kingston Duffie. The two seem like old friends, which isn't so surprising: Yang's Institutional Venture Partners made \$10 million, a 250% return, in April when Duffie, a 36-year-old engineer, sold his first company, White-tree Inc., to Ascend Communications Inc. for \$66 million. Now, they are hashing out Duffie's vision for a second start-up, another telecom concept, and their conversation bubbles with talk of NSPs, DSPS, and IDSLs.

Even before the bagels and fruit shakes are carted away, Yang, who is hearing the still-fuzzy concept for the

first time, offers Duffie \$100,000 and an office to help him explore the idea further. His message is clear. "I want to be involved with just about whatever he does," says Yang. "Everyone will be all over Duffie. I'm trying to lock this up before anybody else knows about it." No commitments are made, but Yang suspects his no-strings-attached overture has served its purpose.

Down the road at Il Fornaio, another popular Valley breakfast spot, venture capitalist Gill Cogan is engaged in a similar ritual. His target is Joseph J. Raffa, a 36-year-old marketing whiz who made his name at Hewlett-Packard Co. and software maker Synopsys Inc. Cogan, a partner at Weiss, Peck & Greer Venture Partners, wants Raffa to help run one of the companies in his \$205 million fund. He already has bought Raffa a fancy cell phone and given him the unique opportunity to invest in some of the firm's deals. "It will pay off hand-

somely," says Cogan. "We know he's going to do something good, and we want him to call us first."

Dealmaking, Silicon Valley-style. Nearly every day of the week, venture capitalists, entrepreneurs, and résumé-bearing executives pile into the same half-dozen haunts, constantly bumping into one another as they attempt to seal the deal of the day. The object of the game: money. Venture capitalists, in fierce competition with one another for the next Netscape Communication Corp. or Yahoo! Inc., want to multiply it. Entrepreneurs simply want it.

Without their frenetic mating dance, Silicon Valley couldn't be the technological mecca it is today. Indeed, no place else in the world hosts so many venture investors eager to dump money into the untested ideas of young entrepreneurs—all on the off chance that they can overcome inevitable startup snafus to reach powerhouse status. Of some 600 venture firms nationwide, about half call Silicon Valley home, according to the National Venture Capital Assn. These firms establish funds and then drum up the money—no hard sell these days. Money flows in from pension funds, insurers, and endowments around the world, all hoping to achieve annual returns as high as 50%. Then the hunt for hot deals is on.

Outside of Hollywood, this is, perhaps, the business world's ultimate continuous schmooze-fest. Yang's Menlo Park-based firm alone spends some \$400,000 a year on networking, with



More on finding capital: See CNBC at 10 a.m. and 5 p.m. EDT Aug. 11

NEW GAME Yang holds a 9 a.m. working session with GolfWeb CEO Brent Knudsen, whom Yang funded, and venture capitalist Todd Francis



WORDS ARE MONEY All time is schmooze time, whether in the office, in the car, or visiting companies. Networking is the stuff of deals for venture capitalists

ood reason. Competition for the sexiest deals and hottest talent is keener than ever as money flows into the industry at an unprecedented rate. In just four years, venture investments in Silicon Valley have soared 188%, to \$2.2 billion in 1996, accounting for 35% of all information technology venture capital investments in the U.S., according to industry tracker VentureOne Corp. (Nasdaq: VENT). The Valley's share of the total has slipped in recent years, but that's because firms have put relatively more funding into the area's booming startups, which tend to require less capital per deal than young companies in later stages.

HIGH CASUALTIES. Big money, of course, what oils the Valley's gearbox. "It really turbocharges the development of new ideas into new industries," says David Gleba, chairman of VentureOne. Yet while the flood of capital has intensified, the number of promising deals remains finite. Venture capitalists aim to multiply their money in any one company at least tenfold within four years, but at Seagate Technology Inc., which bought Yang's firm a \$56.5 million profit on its \$500,000 investment, is rare. Ultimately, one in three investments produces a total write-off.

To separate the gold-plated winners from the also-rans, VC firms sort through teams of prospects, evaluating ideas, management, and potential markets. New Enterprise Associates reviews 3,000 business plans each year and ends up fund-

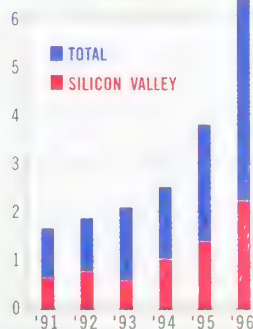
ing just 20 companies. Hummer Winblad Venture Partners culls through 1,600 plans to come up with 10 worth seeding. "We don't want to fund dipsticks," says partner Ann L. Winblad.

But venture capitalists have become more than financial analysts with big checkbooks. Indeed, the best of the lot wear a wide array of hats—from executive recruiter to corporate strategist to networker to salesman. They're aggressive, hands-on investors, demanding an active role in setting the course for their companies. "Our job is to multiply money by a lot, not a little," says Bruce W. Dunlevie, a partner at Benchmark Capital Management in Menlo Park. "You do what has to be done."

After wooing Raffa over breakfast, for example, Cogan heads to Terayon Corp., a cable-modem startup that Weiss, Peck & Greer funded in 1995.

THE CAPITAL FLOOD

Silicon Valley companies' share of venture capital raised for technology businesses



DATA: VENTUREONE

▲BILLIONS OF DOLLARS

The Santa Clara company is preparing to raise its third round of financing. Cogan, whose early-round investment will be affected by the valuation from the new round, wants to preview the pitch. He is not impressed by what he sees—a verbose, poorly organized slide show. So the 43-year-old venture veteran and his partners roll up their sleeves to sharpen the company's message and spice up the graphics. "This is a very exciting company, but nobody would have known from listening to this damn presentation," says Cogan.

Often, it's the VCs' Rolodexes that make deals happen. At a recent meeting with Com21 Inc. in Fremont, C. Richard Kramlich of New Enterprise Associates promises to hook up the cable-modem company with John Sidgmore, a top exec at potential customer WorldCom Inc. Another investor, Will Hearst, a partner at Kleiner Perkins Caufield & Byers, already has introduced Com21 to senior execs at Tele-Communications Inc. and to Thomas A. Jermoluk, CEO of @Home Corp., a cable-based Net service. "They have opened the door for us," says Com21 President and CEO Peter D. Fenner.

Who you know counts for a lot in the Valley. But what you're willing to do for them counts for even more. VC legend L. John Doerr, a self-described "recruiting animal," logged tens of thousands of miles over nine months, shuttling to Austin, Tex., Washington D.C., Los Angeles, and Aspen, Colo., to win Michael Long, head of software

Time Saving Technology Tips for Busy Executive

Fourth in a Series Sponsored by AT&T

A SECURE WAY TO RAISE FUNDS ON THE WEB

Labor Day is just around the corner, and with it come the many annual rites of autumn. The changing leaves. The start of school. And Jerry Lewis.

Jerry Lewis? That's right. For 31 years, Jerry and hundreds of entertainers, sports luminaries and pacesetters in business and public life have been raising money for the Muscular Dystrophy Association (MDA) by appearing on the nation's longest-running, most successful televised fund-raiser—the Jerry Lewis MDA Labor Day Telethon.

Each year, nearly a million Telethon volunteers join Jerry Lewis to help raise funds to fight 40 neuromuscular diseases. This year, they'll have a little more help than usual...from technology.

Technology that can work just as well for nonprofit organizations as it does for general business. Because, when it comes to customer relations, both have a lot in common. While for-profit businesses use customer relations programs to increase their market share, nonprofits employ them to expand their donor bases. And technology is proving to be an increasingly powerful way of doing just that.

USING THE WEB TO RAISE FUNDS

The MDA Telethon has traditionally used telephone banks staffed by long rows of volunteers to take pledges from viewers calling local and toll-free numbers displayed on their television screens. Volunteers will continue to staff the phones around the clock. This September, the Telethon will tap into a new source for donations—the growing popularity of cyberspace where donors can make contributions directly over the Web (see sidebar).

AT&T MAKES IT ALL POSSIBLE

The online donation plan, as attractive as it is, initially faced a possible stumbling block: the willingness of would-be donors to use credit cards over the Internet. MDA overcame this challenge by turning to AT&T. As part of its Web Site Services, the company incorporated AT&T SecureBuySM Service—its industry-leading secure Web commerce solution—directly into the MDA Web site.

"When you're soliciting donations, it's vital that the system be easy to use, reliable and secure—both for MDA and its donors," observes Robert Ross, MDA senior vice-president and executive director. "AT&T SecureBuy Service is an ideal solution because it includes advanced encryption protocols and impenetrable firewalls. Donors' credit card information is protected by ironclad security." And, continues Ross, "Just like for-profit businesses, MDA is always looking for new ways to improve efficiencies, to generate new revenue growth, and to build contributor relationships. Now, www.mdaua.org is a cost-efficient vehicle for communicating—and fund-raising."



LENDING A HELPING HAND

AT&T, an MDA national sponsor, is assisting the 1997 Jerry Lewis MDA Labor Day Telethon in other ways as well. AT&T has placed its powerful telecommunications network at MDA's disposal, enabling the Telethon to meet the anticipated high levels of contributor demand. The company also will send two free 50-minute prepaid calling cards to every registered SecureBuy cyber-donor contributing \$25 or more. And it is providing hotlinks to the MDA Web site from many of its own Web pages.

To learn more about AT&T Web Site Services and AT&T SecureBuy Service, visit www.att.com/easyccommerce or call 1-800-7HOSTIN, ext. MDA. In addition to helping "Jerry's kids,"[®] AT&T may be able to find ways to help improve your company's customer relations programs as well.

HOW TO CONTRIBUTE

The MDA online donation process is simple. To make contributions over the Internet, viewers need only follow five easy steps:

1. Log on to the MDA Web site (<http://www.mdaua.org>)
2. Click on the "Telethon Donation" icon
3. Select a donation option
4. Fill out the online registration form
5. Indicate the dollar amount of the donation and provide a valid credit card number

That's it. No stamps, no checks, no lost time in the mail. Viewers can begin doing good starting Labor Day, September 1, 1997...and "Jerry's kids" can start benefiting immediately.

Kenneth R. Hopkins, who heads a San Diego-based corporate communications company, writes frequently about technology and telecommunications.



this on for size. AT&T Web Site Services can help your business get up running on the Internet in a way that's tailor-made for your company.



It's all within your reach

THE DIRECTOR'S CHAIR At 9 a.m. the next day, he joins a board meeting at Whistle Communications with Chief Executive John Hamm (right) and board member Dave Brown



LONG DAY By midday, Yang is getting a demo of Interjet technology. And so it goes, until evening, when Yang spends time with his most important startup, daughter Megan

maker CSC Continuum Inc., for the CEO job at Palo Alto-based Healthcon Corp., a startup funded by Kleiner Perkins. When it came to finding a CEO for @Home, Doerr interviewed 55 candidates in hotel rooms across the country before settling on Jermoluk.

Benchmark Capital's Dunlevie took a different tack to snag James Jordan. In 1992, Jordan, a successful 57-year-old networking expert, was reluctant to take the helm of Kalpana Inc., a networking company that sorely needed seasoned management. Dunlevie, who had funded Kalpana in 1990, persuaded Jordan to try it for three months. When Jordan grumbled about missing his favorite pastimes, Dunlevie arranged for the exec to go salmon fishing in Alaska and (though a nonhunter himself) went dove shooting with him in New Mexico.

CHEAP CAR. When Jordan later worried about not having time for personal matters, such as selling his wife's car, Dunlevie stepped in again: "I bought this guy's car just to remove an objection to running the company," recalls Dunlevie. His efforts paid off: Jordan revived Kalpana, and in 1994, sold it to Cisco Systems Inc. for stock now worth more than \$1 billion. Dunlevie's return: about \$61 million on a \$3.8 million investment.

The maneuvering, indeed, is ceaseless. Executives in demand can name their price. And startups with the right technology and team can play VC firms against each other to win ever-higher valuations. Who, for instance, will bag Tumbleweed Software Inc.? The Red-

wood City-based startup, which makes software that allows companies to send documents securely over the Internet, has pitched 20-plus Silicon Valley firms to raise \$6 million. Now, 30-year-old CEO Jeffrey C. Smith gets to handpick his investors. "At this point, everyone's money is green," Smith says. "Now, it's about who would be the best partner."

On a whiteboard, he divides his suitors into five categories: in, hot, warm, cold, and out. The first cut is easy: Hambrecht & Quist, which manages a fund for Adobe Systems Inc., will win a lead position with Bessemer Venture Partners and original investor Draper Fisher Jurvetson. He dismisses the "colds" and "outs," including tony Mayfield Fund, which will invest only if Smith agrees to relinquish the helm, a request often made of bright but inexperienced entrepreneurs. The "warms" are largely axed, too—one simply because the partner on the deal got sick, another because of too few connections.

Days later, the action escalates. Venture newcomer Generation Partners raises the ante with a valuation worth \$4 million more than H&Q's. At the same time, Microsoft Corp. board member David F. Marquardt, who runs August Capital, offers \$3 million less but brings access to his blue-chip contacts. "Marquardt is right about his value," says Smith. "But I'm not sure he's \$3 million right." When the dust clears, Smith snags a higher valuation than originally expected, and a total of \$7 million in capital. H&Q kicks in \$3.5 million; Besse-

mer puts in \$2 million, with Dra Fisher taking the remaining \$1.5 million. Generation, late to the party lacking marquee value, loses out.

Will Tumbleweed prove a winner? Who knows? The sobering reality of the Valley is that much of the wooing led to failure or mediocrity. Winblad's first lost \$1.2 million investing in Slate Co, a pen-based computing software start-up. Atherton Technology, an object-oriented software company launched by entrepreneur William G. Paseman and funded by Kleiner Perkins and Mayfield, was bust after five years in business.

Still, up and down the Valley, Hobe's and Il Fornaio, in conference rooms and on car phones, the pursuit persists. Paseman, in fact, soon went to form Calico Technology Inc., another software venture—funded by the same VC firms burned by Atherton. While Amid the bagels and shakes, across phone lines and on E-mail, entrepreneurs and venture capitalists alike sense a glimmer of the next dazzling technology. The Big One. Says Neal Margulis, a 32-year-old who's pitching a home-computer networking company to Benchmark Capital: "It's easy to come up with \$50 million niche ideas. But they aren't worth doing. When you start thinking of the ones that could be \$1 billion companies, that's when it becomes interesting."

Indeed, that's when the Valley's money starts flowing.

By Linda Himelstein, with Peter Burrows and Andy Reinhardt, in Silicon Valley

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WITHOUT THE RIGHT COVERAGE, YOUR COMPANY CAN BE FLATTENED BY A TRAIN THAT'S STANDING STILL.

All it takes is a rail strike, a streak of bad weather or a sudden change in an exchange rate and your company's bottom line can sustain a major injury. So businesses require a partner that can anticipate and protect against multiple risks with innovative solutions.

AIG Risk Finance is that partner. With our financial resources, insurance underwriting and capital markets expertise, we can bundle together risks other financial institutions can't manage. When AIG Risk Finance combines a company's financial and insurance risk into a single program, the integrated coverage can create efficiencies that might not be realized using traditional forms of risk management.

For instance, our Commodity-Embedded Insurance (COIN) program limits the earnings per share impact for our clients by joining traditional insurance risks with financial exposures like primary commodities, foreign exchange and interest rate fluctuations. AIG Risk Finance, a division of the AIG Companies, has access to an unparalleled global network, with operations in approximately 130 countries and jurisdictions worldwide. And we have top financial ratings to back us up. So we'll be there to help your business stay on the right track.



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At your age, with your high cholesterol, what's your risk of a first heart attack?

If you have high cholesterol, figure your risk of a first heart attack.

Fill in your points for each risk factor.

- | | |
|---|---|
| ☐ Age: Men
0 pts. Less than 35 2 pts. 40 to 48 4 pts. 54+
1 pt. 35 to 39 3 pts. 49 to 53 | ☐ Total Cholesterol Level:
0 pts. Less than 240 mg/dL
1 pt. 240 to 315 mg/dL
2 pts. More than 315 mg/dL |
| ☐ Age: Women
0 pts. Less than 42 2 pts. 45 to 54 4 pts. 74+
1 pt. 42 to 44 3 pts. 55 to 73 | ☐ HDL Level (good cholesterol):
0 pts. 39 to 59 mg/dL
1 pt. 30 to 38 mg/dL
2 pts. Under 30 mg/dL
-1 pt. Over 60 mg/dL |
| ☐ Family History:
2 pts. My family has a history of heart disease or heart attacks before the age of 60 | ☐ Blood Pressure:
I don't take blood pressure medication; my blood pressure is:
(Use your top or higher blood pressure number)
0 pts. Less than 140 mmHg
1 pt. 140 to 170 mmHg
2 pts. Greater than 170 mmHg
(or)
1 pt. I am currently taking blood pressure medication |
| ☐ Inactive Lifestyle:
1 pt. I rarely exercise or do anything physically demanding | |
| ☐ Weight:
1 pt. I'm more than 20 lbs. over my ideal weight | |
| ☐ Smoking:
1 pt. I'm a smoker | |
| ☐ Diabetic:
1 pt. Male Diabetic
2 pts. Female Diabetic | |

☐ **Total Points**

If you scored 4 points or more, you could be at above average risk of a first heart attack compared to the general adult population. The more points you score, the greater your risk.

If you have already had a heart attack or have heart disease, your heart attack risk is significantly higher. **Only your doctor can evaluate your risk and recommend treatment plans to reduce your risk.** If you don't know your cholesterol level or blood pressure, ask your doctor if your levels should be checked.

Provided as an educational service from Bristol-Myers Squibb Company.

American Heart
Association™
*Fighting Heart Disease
and Stroke*



Pravachol, in combination with diet, is proven to reduce the risk of a first heart attack, reduce the risk of death from heart disease, and reduce the need for surgery to clear blocked coronary

arteries (such as bypass or angioplasty) based on a landmark study including over 6,500 males with high cholesterol and no evidence of heart disease. Because Pravachol is a prescription

drug, you should ask your doctor or healthcare professional if Pravachol is right for you. Some mild side effects, such as slight rash or stomach upset, occur in about 2-4% of patients.

PRAVACHOL[®]

Proven to help prevent first heart attacks in people with high cholesterol.

PRAVACHOL is the only cholesterol-lowering drug of its kind proven to help prevent first heart attacks. And the grim fact is, up to 33% of people do not survive their first heart attack. Improving your diet and exercise is an important first step, but may not be enough. So ask

your doctor about PRAVACHOL. It reduces the risk of a first heart attack and the need for surgery to clear blocked coronary arteries. PRAVACHOL has been prescribed by doctors for millions of men and women worldwide. It could help you live a longer, healthier life.

Ask your doctor if PRAVACHOL is right for you. Or call **1-800-PREVENT** for information on *first heart attack prevention* including a free brochure from the American Heart Association. It's all provided by Bristol-Myers Squibb.



**Proven to help prevent
first heart attacks.**

Visit our Web site at www.pravachol.com

PRAVACHOL should not be taken by women who are pregnant or nursing, people who are allergic to any of its ingredients or by anyone with liver disease. Your doctor may perform simple

blood tests to check your liver function before and during treatment with PRAVACHOL. Muscle pain or weakness could be a sign of a rare but serious side effect and should be reported to your

doctor right away. Be sure your doctor knows about other medications you may be taking in order to avoid any possible serious drug interactions. Please see important information on the next page.

CONTRAINDICATIONS: Hypersensitivity to any component of this medication. Active liver disease or unexplained, persistent elevations in liver function tests (see **WARNINGS**). *Pregnancy and lactation* Atherosclerosis is a chronic process and discontinuation of lipid-lowering drugs during pregnancy should have little impact on the outcome of long-term therapy. However, the potential for fetal hypocholesterolemia exists. Cholesterol and other products of cholesterol biosynthesis are essential components for fetal development (including synthesis of steroids and cell membranes). Since HMG-CoA reductase inhibitors decrease cholesterol synthesis and possibly the synthesis of other biologically active substances derived from cholesterol, they may cause fetal harm when administered to pregnant women. Therefore, HMG-CoA reductase inhibitors are contraindicated during pregnancy and in nursing mothers. **Pravastatin should be administered to women of childbearing age only when such patients are highly unlikely to conceive and have been informed of the potential hazards.** If the patient becomes pregnant while taking this class of drug, therapy should be discontinued and the patient apprised of the potential hazard to the fetus.

WARNINGS: Liver Enzymes: IG-CoA reductase inhibitors (e.g., some other lipid-lowering therapies) have been associated with chemical abnormal findings of liver function. Increases of serum transaminase (ALT, AST) values to more than 3 times the upper limit of normal occurring on 2 or more (not necessarily sequential) occasions have been reported in 1.3% of patients treated with pravastatin in the US over an average period of 18 months. These abnormalities were not associated with cholestasis and did not appear to be related to treatment duration. In those patients in whom these abnormalities were believed to be related to pravastatin and who were discontinued from therapy, the transaminase levels usually fell slowly to pretreatment levels. These biochemical findings are usually asymptomatic, although worldwide experience indicates that anorexia, weakness, and/or abdominal pain may also be present in rare patients. In the largest long-term placebo-controlled clinical trial for pravastatin (Pravastatin Primary Prevention Study, see **Clinical Pharmacology**), the overall incidence of AST and/or ALT elevations to greater than three times the upper limit of normal was 1.05% in the pravastatin group as compared to 0.75% in the placebo group. One (0.03%) pravastatin-treated patient and 2 (0.06%) placebo-treated patients were discontinued because of transaminase elevations. Of the patients with normal liver function at week 12, three of 2875 treated with pravastatin (0.10%) and one of the 2919 placebo patients (0.03%) had elevations of AST greater than three times the upper limit of normal on two consecutive measurements and/or discontinued due to elevations in transaminase levels during the 4.8 years (mean treatment) of the study. **It is recommended that liver function tests be performed prior to and at 12 weeks following initiation of therapy or the elevation of dose.** Patients who develop increased transaminase levels or signs and symptoms of liver disease should be monitored with a second liver function evaluation to confirm the finding and be followed thereafter with frequent liver function tests until the abnormalities return to normal. Should an increase in AST or ALT of three times the upper limit of normal or greater persist, withdrawal of pravastatin therapy is recommended. Active liver disease or unexplained transaminase elevations are contraindications to the use of pravastatin (see **CONTRAINDICATIONS**). Caution should be exercised when pravastatin is administered to patients with a history of liver disease or heavy alcohol ingestion (see **CLINICAL PHARMACOLOGY: Pharmacokinetics/Metabolism**). Such patients should be closely monitored, started at the lower end of the recommended dosing range and titrated to the desired therapeutic effect. **Skeletal Muscle: Rare cases of rhabdomyolysis with acute renal failure secondary to myoglobinuria have been reported with pravastatin and other drugs in this class.** Uncomplicated myalgia has also been reported in pravastatin-treated patients (see **ADVERSE REACTIONS**). Myopathy defined as muscle aching or muscle weakness in conjunction with increases in creatine phosphokinase (CPK) values to greater than 10 times the upper normal limit was rare (< 0.1%) in pravastatin clinical trials. Myopathy should be considered in any patient with diffuse myalgias, muscle tenderness or weakness, and/or marked elevation of CPK. Patients should be advised to report promptly unexplained muscle pain, tenderness or weakness, particularly if accompanied by malaise or fever. **Pravastatin therapy should be discontinued if markedly elevated CPK levels occur or myopathy is diagnosed or suspected.** Pravastatin therapy should also be temporarily withheld in any patient experiencing an acute or serious condition predisposing to the development of renal failure secondary to rhabdomyolysis, e.g., sepsis; hypotension; major surgery; trauma; severe metabolic, endocrine, or electrolyte disorders; or uncontrolled epilepsy. The risk of myopathy during treatment with another HMG-CoA reductase inhibitor is increased with concurrent therapy with either erythromycin, cyclosporine, niacin, or fibrates. However, neither myopathy nor significant increases in CPK levels have been observed in three reports involving a total of 100 post-transplant patients (24 renal and 76 cardiac) treated for up to two years concurrently with pravastatin 10-40 mg and cyclosporine. Some of these patients also received other concomitant immunosuppressive therapies. In one single-dose study, pravastatin levels were found to be increased in cardiac transplant patients receiving cyclosporine. Further, in clinical trials involving small numbers of patients who were treated concurrently with pravastatin and niacin, there were no reports of myopathy. Also, myopathy was not reported in a trial of combination pravastatin (40 mg/day) and gemfibrozil (1200 mg/day) although 4 of 75 patients on the combination showed marked CPK elevations versus one of 73 patients receiving placebo. There was a trend toward more frequent CPK elevations and patient withdrawals due to musculoskeletal symptoms in the group receiving combined treatment as compared with the groups receiving placebo, gemfibrozil or pravastatin monotherapy (see **PRECAUTIONS: Drug Interactions**). The use of fibrates alone may occasionally be associated with myopathy. The combined use of pravastatin and fibrates should be avoided unless the benefit of further alterations in lipid levels is likely to outweigh the increased risk of this drug combination.

RECAUTIONS: General: Prastatin may elevate creatinine phosphokinase and transaminase levels (see **ADVERSE REACTIONS**). This should be considered in the differential diagnosis of chest pain in a patient on therapy with prastatin. **Homozygous Familial Hypercholesterolemia** Prastatin has not been evaluated in patients with rare homozygous familial hypercholesterolemia. In this group of patients it has been reported that HMG-CoA reductase inhibitors are less effective because the patients lack functional LDL receptors. **Renal Insufficiency** A single 60 mg oral dose of prastatin was administered to 24 patients with varying degrees of renal impairment (creatinine clearance by creatinine clearance). No effect was observed on the pharmacokinetics of prastatin or its 3 α -hydroxy, some metabolite, SO 31906. A small increase was seen in mean AUC values and half-life ($t_{1/2}$) for the inactive enzymatic hydrolysis metabolite SO 31945. Given this small sample size, the dosage administered, and the degree of individual variability in patients with renal impairment, it is recommended prastatin should be closely monitored. **Information for Patients:** Patients should be advised to report promptly unexplained muscle pain, tenderness or weakness, particularly if accompanied by malaise or fever. **Drug Interactions:** *Cimetidine*, *Cisplatin*, *Digoxin*, *Gemfibrozil*, *Niacin*, *Nicotinic Acid*, *Erythromycin* See **WARNINGS**. **Skeletal Muscle Ankyriosis:** Similar to the administration of prastatin had no effect on the clearance of anhydrous interactions with other drugs metabolized in the liver. hepatic cytochrome isozymes are not expected. **Cholestyramine**, **Colestipol** Concomitant administration resulted in an approximately 40 to 50% decrease in the mean AUC of prastatin. However, when prastatin was administered 1 hour before or 4 hours after colestyramine or 1 hour before colestipol and a standard meal, there was no clinically significant decrease in bioavailability or therapeutic effect. (See **DOSE AND ADMINISTRATION: Concomitant Therapy**). **Warfarin** In a study involving 10 healthy male subjects given prastatin and warfarin concomitantly for 6 days, bioavailability parameters at steady state for prastatin (parent compound) were not altered. Prastatin did not alter the plasma protein-binding of warfarin. Concomitant dosing did increase the AUC and C_{max} of warfarin but did not produce any changes in its anticoagulant action (i.e., no increase was seen in mean prothrombin time after 6 days of concomitant therapy). However, bleeding and extreme prolongation of prothrombin time has been reported with another drug in this class. Patients receiving warfarin: type anticoagulants should have their prothrombin times closely monitored when prastatin is initiated or the dosage of prastatin is changed. **Cimetidine** The AUC for prastatin when given with cimetidine was not significantly different from the AUC for prastatin when given alone. A significant difference was observed between the AUCs for prastatin when given with cimetidine compared to when administered with antacid. **Digoxin** In a crossover trial involving 18 healthy male subjects given prastatin and digoxin concurrently for 9 days, the bioavailability parameters of digoxin were not affected. The AUC of prastatin tended to increase, but the overall bioavailability of prastatin plus its metabolites SO 31906 and SO 31945 was not altered. **Cyclosporine** Some investigators have measured cyclosporine levels in patients on prastatin, and to date, there are no clinical data on clinically meaningful elevations in cyclosporine levels. In one single-dose study prastatin levels were found to be increased in cardiac transplant patients receiving cyclosporine. **Gemfibrozil** In a crossover study in 20 healthy male volunteers given concomitant single doses of prastatin and gemfibrozil, there was a significant decrease in urinary excretion and protein binding of prastatin. In addition, there was a significant increase in AUC, C_{max}, and T_{max} for the prastatin metabolite SO 31906. Combination therapy with prastatin and gemfibrozil is generally not recommended. In interaction studies with aspirin, antacids 1 hour prior to PRAVACHOL, cimetidine, nicotinic acid, or probucol no statistically significant differences in bioavailability were seen when PRAVACHOL prastatin sodium was administered. **Other Drugs** During clinical trials, no noticeable drug interactions were reported when PRAVACHOL was added to diuretics, antihypertensives, digitalis, ACE inhibitors, calcium channel blockers, beta-blockers or nitroglycerin. **Endocrine Function:** HMG-CoA reductase inhibitors interfere with cholesterol synthesis and lower circulating cholesterol levels and as such might theoretically blunt adrenal or gonadal steroid hormone production. Results of clinical trials with prastatin in males and post-menopausal females were inconsistent with regard to possible effects of the drug on basal steroid hormone levels. In a study of 21 males the mean testosterone response to human chorionic gonadotropin was significantly reduced (p < 0.004) after 16 weeks of treatment with 40 mg of prastatin. However, the percentage of patients showing a > 50% rise in plasma testosterone after human chorionic gonadotropin stimulation did not change significantly after therapy in these patients. The effects of HMG-CoA reductase inhibitors on spermatogenesis and fertility have not been studied in adequate numbers of patients. The effects, if any, of prastatin on the pituitary-gonadal axis in pre-menopausal females are unknown. Patients treated with prastatin who display clinical evidence of endocrine dysfunction should be evaluated appropriately. Caution should also be exercised if an HMG-CoA reductase inhibitor or other agent used to lower cholesterol levels is administered to patients also receiving other drugs in the class. **CNS Toxicity:** *Cimetidine* may diminish the levels or activity of steroid hormones. **CNS Toxicity:** **CNS** vascular lesions characterized by perivascular hemorrhage and edema and mononuclear cell infiltration of perivascular spaces were seen in dogs treated with prastatin at a dose of 25 mg/kg/day a dose that produced a plasma drug level about 50 times higher than the mean drug level in humans taking 40 mg/kg/day. Similar CNS vascular lesions have been observed with several other drugs in this class. A chemically similar drug in this class produced optic nerve degeneration (Wallerian degeneration of retinogeniculate fibers) in clinically normal dogs in a dose-dependent fashion starting at 60 mg/kg/day a dose that produced mean plasma drug levels about 30 times higher than the mean drug level in humans taking the highest recommended dose (as measured by total enzyme inhibitory activity). This same drug also produced vestibulocochlear (Wallerian) degeneration and retinal ganglion cell chromatolysis in dogs treated for 14 weeks at 180 mg/kg/day, a dose which resulted in a mean plasma drug level similar to that seen with the 60 mg/kg/day dose. **Carcinogenesis, Mutagenesis**

Increased Fertility. In a 2-year study in rats fed pravastatin at doses of 10, 30, or 100 mg/kg body weight, there was no observed incidence of hepatocellular carcinomas in males at the highest dose ($p < 0.01$). Although rats were given 10 times the human dose (HD) on a mg/kg body weight basis, serum drug levels were only 6 to 10 times higher than measured in humans given 40 mg pravastatin as measured by AUC. The oral administration of 10, 30, or 100 mg/kg plasma drug levels approximately 0.5 to 5 times the human drug levels (at 40 mg) of pravastatin to mice for 22 weeks resulted in a statistically significant increase in the incidence of malignant lymphomas in treated females when all three groups were pooled and compared to controls ($p < 0.05$). The incidence was not dose-related and male mice were not affected. A chemically similar drug in this class was administered to mice for 72 weeks at 25, 100, and 400 mg/kg body weight, resulting in mean serum drug levels approximately 3, 15, and 33 times higher than the mean human serum drug concentration (as total inhibitory activity) after a 40 mg oral dose. Liver carcinomas were significantly increased in high-dose females in mid- and high-dose males, with a maximum incidence of 90 percent in males. The incidence of adenomas of the liver was significantly increased in mid- and high-dose females. Drug treatment also significantly increased the incidence of adenomas in mid- and high-dose males and females. Adenomas of the eye Harderian gland (a gland of the eye of rodents) were significantly higher in high-dose mice than in controls. No evidence of mutagenicity was observed *in vitro*, with or without metabolic activation in the following studies: microbial mutagen tests, using mutant strains of *Salmonella typhimurium* and *Escherichia coli*, a forward mutation assay in L5178Y TK +/– mouse lymphoma cells, a chromosomal aberration test in mouse cells, and a gene conversion assay using *Saccharomyces cerevisiae*. In addition, there was no evidence of mutagenicity or a significant increase in incidence of micronucleated testis in mice. In a study in rats, with daily doses up to 500 mg/kg pravastatin did not produce any adverse effects on fertility or general reproductive performance. However, in a study in which HMG CoA reductase inhibitors were given to pregnant rats, there was an observed decrease in the number of live offspring, although this effect was not observed in a subsequent fertility study when the rats were treated with pravastatin throughout the entire cycle of spermatogenesis, including epididymal maturation). In rats treated with 100 mg/kg pravastatin throughout the pregnancy, perinatal tubule degeneration (necrosis and loss of spermatogenic epithelium) was observed after pravastatin. Two similar drugs in this class caused drug-related testicular atrophy, decreased spermatogenesis, spermatocyte degeneration, and germ cell formation in dogs. The clinical significance of these findings is unclear. **Pro-**

Pregnancy Category X. See **CONTRAINDICATIONS**. Safety in pregnant women has not been established. Pravastatin is teratogenic in rats at doses up to 1000 mg/kg daily or in rabbits at doses of up to 50 mg/kg daily. These doses resulted in 100% (14 of 14) resorptions in rabbits at doses of 1000 mg/kg daily and 100% (24 of 24) resorptions in rabbits at doses of 50 mg/kg daily or 240x (rat) the human exposure based on surface area (mg/m²). However, in studies with another HMG-CoA reductase inhibitor, skeletal malformations were observed in rats and mice. There has been one report of severe concha deformity, tracheo-esophageal fistula, and anal atresia (fetus association) in a baby born to a woman who took pravastatin 40 mg daily during pregnancy. In a study of pregnant women taking pravastatin 40 mg daily, no congenital anomalies were observed. However, because of the potential for fetal harm, pravastatin should be administered to women of child-bearing potential only when such patients are highly unlikely to become pregnant and have been informed of the potential hazards. If the woman becomes pregnant while taking pravastatin (pravastatin sodium), it should be discontinued and the patient advised again as to the potential hazards to the fetus. **Nursing Mothers.** Small amount of pravastatin is excreted in human breast milk. Because of the potential for serious adverse reactions in infants, women taking pravastatin should not nurse. See **CONTRAINDICATIONS**. **Pediatric Use:** Safety and effectiveness in children less than 18 years old have not been established. Hence, treatment in patients less than 18 years old is not recommended at this time.

ADVERSE REACTIONS: Pravastatin is generally well tolerated; adverse reactions have usually been mild and transient. In month placebo-controlled trials, 17% of pravastatin-treated patients and 12% of placebo-treated patients discontinued from treatment because of adverse experiences attributed to study drug therapy; this difference was statistically significant. In long-term studies, the most common reasons for discontinuation were asymptomatic transaminase increases and mild, non-specific gastrointestinal complaints. During clinical trials, the overall incidence of events in the elderly was not different from the incidence observed in younger patients. **Adverse Clinical Events:** All events reported in clinical trials are listed in Table 1. In the placebo-controlled trials, 10% of pravastatin-treated patients and 12% of placebo-treated patients were identified in the table below, also shown are the percentages of patients in whom these medical events were related or possibly related to the drug.

Body System/Event	All Events		Events Attributed to Study Drug	
	Pravastatin (N = 900) %	Placebo (N = 411) %	Pravastatin (N = 900) %	Placebo (N = 411) %
Central Nervous System				
Dizziness	4.0	3.4	1	3.4
Disturbance of Attention	4.0*	1.1	1.1	0.0
Gastrointestinal				
Flatulence or Bloating	7.3	7.1	2.9	3.4
Diarrhea	5.4	5.4	2.1	1.9
Abdominal Pain	5.4	5.4	2.1	4.4
Constipation	4.0	7.1	2.4	5.1
Stomatitis	3.3	3.6	2.7	3.4
Heartburn	2.9	1.9	2.0	0.7
General				
Fatigue	3.8	3.4	1.1	1.9
Chest Pain	3.7	1.9	0.3	0.2
Influenza	2.4*	7	0.0	0.0
Musculoskeletal				
Localized Pain	10.0	9.0	1.1	1.5
Myalgia	7	1.0	0.6	0.0
Nervous System				
Headache	6.2	3.9	1.7*	0.2
Drizziness	3.3	3.2	1.0	0.5
Renal/Genitourinary				
Urinary Abnormalities	2.4	1.1	0.7	1.2
Respiratory				
Common Cold	7.0	6.3	0.0	0.0
Rhinitis	4.0	4.1	0.1	0.0
Cough	2.1	1.7	0.1	0.0

*Statistically significantly different from placebo

In the Pravastatin Primary Prevention Study (West of Scotland) and Coronary Prevention Study (see **CLINICAL PHARMACOLOGY**), involving 6595 patients treated with PRAVACHOL (pravastatin sodium) (N = 3302) or placebo (N = 3293), adverse event profile in the pravastatin group was comparable to that of the placebo group over the median 4.8 year study. The following effects have been reported with drugs in this class, not all the effects listed below have necessarily been associated with pravastatin therapy. *Skeletal* myopathy, rhabdomyolysis, arthralgia. *Neurological* dysfunction of certain nerves including alteration of taste, impairment of extra-ocular movement, facial paresis, tremor, vertigo, memory impairment, peripheral neuropathy, peripheral nerve palsy, anxiety, insomnia, depression. *Hypersensitivity Reaction*: apparent hypersensitivity syndrome has been reported rarely which has included one or more of the following: anaphylaxis, angioedema, lupus erythematosus-like syndrome, polymyalgia rheumatica, dermatomyositis, vasculitis, light sensitivity, leukocytoclastic vasculitis, etc. *Other*: thrombocytopenia, leukopenia, hemolytic anemia, positive ANA, ESR increase, eosinophilia, arthritis, arthralgia, uveitis, asthenia, photosensitivity, fever, chills, flushing, malaise, dyspnea, toxic epidermal necrolysis, erythema multiforme, etc. *Stevens-Johnson syndrome*. *Gastrointestinal*: pancreatitis, hepatitis, including chronic active hepatitis, cholestatic jaundice, fatty change in liver, and rarely cirrhosis, fulminant hepatic necrosis, and hepatoma, anorexia, vomiting. *Skin*: all varieties of skin changes (e.g., nodules, discoloration, dryness of skin/mucous membranes, changes to hair/nails) have been reported. *Reproductive*: gynecostasia, loss of libido, erectile dysfunction. *Eye*: progression of cataracts (lens opacities), glaucoma. *Laboratory Abnormalities*: elevated transaminases, alkaline phosphatase, and bilirubin, thyroid abnormalities. **Laboratory Test Abnormalities:** Increases in serum transaminase (ALT, AST) values and CPK have been observed (see **WARNINGS**). Transient, asymptomatic eosinophilia has been reported. Eosinophil counts usually return to normal despite continued therapy. Anemia, thrombocytopenia, and leukopenia have been reported with HMG-CoA reductase inhibitors. **Concomitant Therapy:** Pravastatin has been administered concurrently with cholestyramine, colestipol (acid product) and gemfibrozil. Preliminary data suggest that the addition of either probucol or gemfibrozil to therapy (lovastatin or pravastatin) is **not** associated with greater reduction in LDL-cholesterol than that achieved with lovastatin alone. No adverse reactions unique to the combination or in addition to those previously reported for each agent have been reported. Myopathy and rhabdomyolysis (with or without acute renal failure) have been reported when a HMG-CoA reductase inhibitor was used in combination with immunosuppressive drugs, gemfibrozil, erythromycin, or lowering doses of nicotinic acid. Concomitant therapy with HMG-CoA reductase inhibitors and these agents is generally recommended (see **WARNINGS**, **Skeletal Muscle** and **PRECAUTIONS**, **Drug Interactions**).

OVERDOSAGE: To date, there are two reported cases of overdosage with pravastatin, both of which were asymptomatic and not associated with clinical laboratory abnormalities. If an overdose occurs, it should be treated symptomatically and supportive measures should be instituted as required.

CAUTION: Federal (USA) law prohibits dispensing without prescription

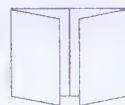
Silicon

**A
GUIDED
TOUR**

Valley



Welcome to the world's high-tech heartland. This 50-mile stretch between San Jose and San Francisco is teeming with more technology than anywhere else on the planet — from the modest little garage that gave birth to the Hewlett-Packard Company to the gleaming towers housing software giant Oracle Corp. Turn the page, hop on the main thoroughfare, Highway 101, and take a ride on the wired side.





Places of Interest

- 68 BERKELEY** Perhaps the greatest public university in the U.S.
- 69 MULTIMEDIA GULCH** Area south of Market Street where the hip new media crowd meets
- 70 3COM PARK** Ex-Candlestick Park, home to 49ers, Giants
- 71 PACIFIC ATHLETIC CLUB** Where the buff hang out
- 72 ATHERTON** Home to millionaires and tear-downs
- 73 SAND HILL ROAD** Epicenter of venture capitalists



- 74 STANFORD LINEAR ACCELERATOR CENTER** Atom-smashing lab drew scientists and research dollars
- 75 STANFORD** Hotbed of high-tech startups and entrepreneurial students
- 76 OLSON'S CHERRIES**

CAUFIELD & BYERS
(Venture capital)

20 INFORMIX (S)

21 HEWLETT-PACKARD
www.hp.com

Computers, printers
FOUNDERS: William Hewlett, David Packard
FOUNDED: 1939

SALES: \$38.42 billion
EARNINGS: \$2.59 billion
EMPLOYEES: 112,000

22 INTERNET TRAVEL NETWORK (I)

23 MARIMBA (I)

24 WILSON, SONSINI, GOOD-RICH & ROSATI (Law firm)

25 SYNTEX ("Pill Hill," pharmaceuticals)

26 VONNET (I)

27 WEBTV (I)

28 XEROX PARC (Research)

29 SUN MICROSYSTEMS

www.sun.com

Computers, Internet software

FOUNDERS: Scott McNealy, Bill Joy, Vinod Khosla, Andy Bechtolsheim
FOUNDED: 1982

1997 SALES: \$8.6 billion
1997 EARNINGS: \$762 million
EMPLOYEES: 17,500

30 SILICON GRAPHICS (C)

31 VARIAN ASSOC. (Instruments)

32 INTUIT (S)

33 ONSALE (I)

34 PLANETWEB (I)

35 NASA AMES (Aerospace)

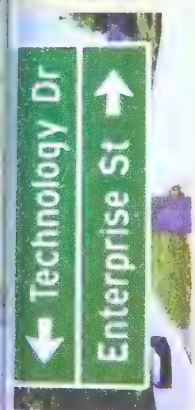
36 VERITY (S)

37 CONNECT (I)

38 NETSCAPE

home.netscape.com

Internet-related software
FOUNDERS: Jim Clark, Marc Andreessen
FOUNDED: 1994
SALES: \$346.2 million
EARNINGS: \$20.9 million
EMPLOYEES: 2,000



Companies

INDUSTRY KEY:

- (SC) Semiconductors
- (I) Internet
- (S) Software
- (ST) Storage
- (C) Computers

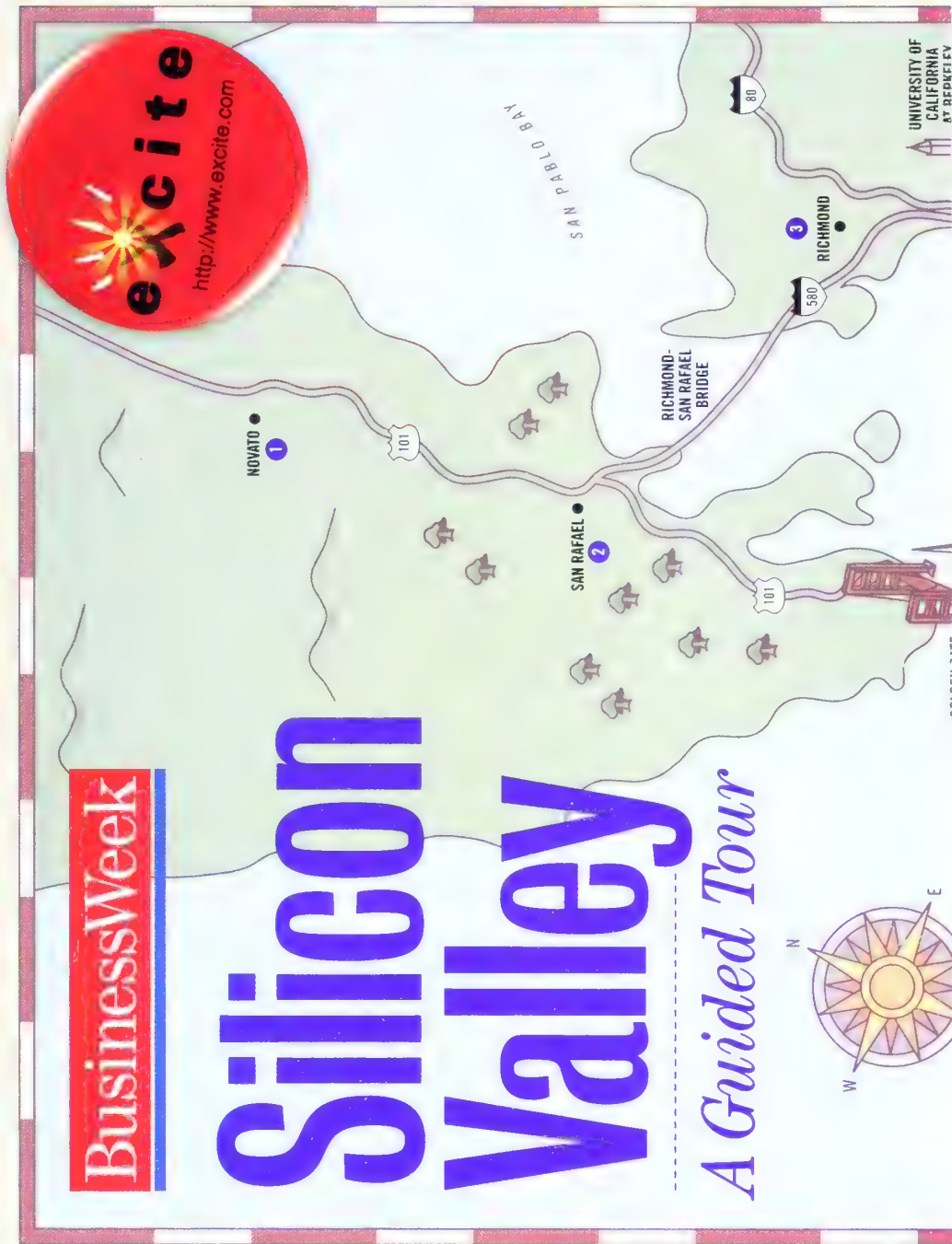
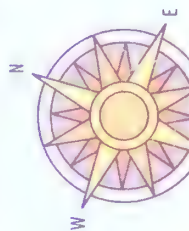
Figures are for 1996 unless noted

- 1 **BRODERBUND** (S)
- 2 **AUTODESK** (S)
- 3 **PIXAR** (Animation)
- 4 **CYBERGOLD** (I)
- 5 **SYBASE** (S)
- 6 **CNET** (I)
- 7 **MACROMEDIA** (S)
- 8 **SALON** (Zine)
- 9 **TOTAL ENTERTAINMENT NETWORK** (I)
- 10 **WIRED** (Magazine)
- 11 **GENENTECH** (Biotech)
- 12 **DIGICASH** (I)
- 13 **ELECTRONIC ARTS** (S)
- 14 **NETGRAVITY** (I, S)
- 15 **ORACLE**
www.oracle.com
Database software
FOUNDER: Larry Ellison
FOUNDED: 1977
1997 SALES: \$5.7 billion
1997 EARNINGS: \$845 million
EMPLOYEES: 29,000
- 16 **EXCITE** (I)
- 17 **NETOBJECTS** (I)
- 18 **AMPEX** (Invented videotape recorder)

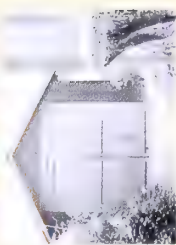
BusinessWeek

Silicon Valley

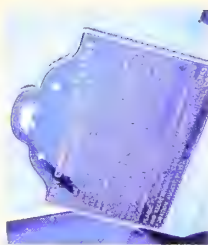
A Guided Tour



Historical Sites



HEWLETT-PACKARD GARAGE
The company's founders made their first audio oscilloscope here in 1938



BIRTHPLACE OF THE CHIP
Now home of a Repo Depot

RICKEY'S HYATT HOUSE
Longtime Palo Alto gathering place

DINAH'S The "Shockley 8" toasted their boss here when he won the Nobel Prize in 1958



STEVE JOBS'S GARAGE



1992

SAP introduces R/3, client-server software destined to change the way businesses do business.

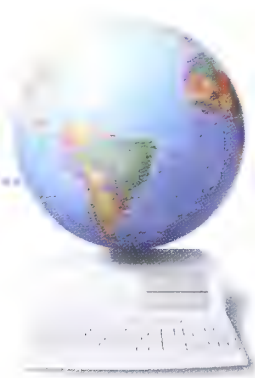
1992

By making R/3 Year 2000 compliant, SAP solves the biggest problem facing the computing world years before it's a problem.



1996

...perfect Technology of ... by ... magazine



1996

With the release of R/3 V3.1 Internet, SAP changes the world of business. Again.



1996

SAP addresses the unique needs of emerging corporations with the introduction of the Certified Business Solutions (CBS) program.



1997

... Business ...



1997

1999 Motorola improves globally with the P-3 HR and Payroll application, providing a foundation for increasing employee information worldwide.



1997

Reckon adds SAP Retail manufacturing solution to create a unified global supply chain.

The Seattle Times
EXTRA! EXTRA!
R/3 Implemented
in eighty-eight days.

1994

SAP makes headlines by implementing R/3 for *The Seattle Times* in 88 days.



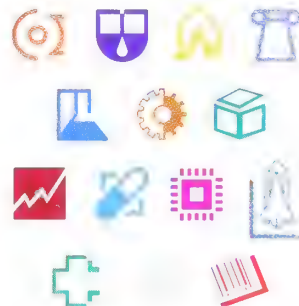
1995

SAP voted one of the Top 10 software vendors by *Software Magazine* 3 years in a row.



1996

AcceleratedSAP program introduced, making rapid implementation a reality.



1995

SAP opens the door for more companies worldwide to work their best with the release of R/3 industry solutions.

To be
continued...



A Better Return On Information

To get the full story on how SAP can help your business, visit us at <http://www.sap.com> or call 1-800-283-1SAP.

Wozniak built the Apple I



Macintosh

S

Get a Year 2000 solution, ASAP.



With R/3 and AcceleratedSAP your Year 2000 problem can be history in a matter of months. SAP client-server software is, and has always been, fully Year 2000 compliant. And the AcceleratedSAP method has been proven to deliver the fastest implementation possible. In fact, customers that have used it have gone live under budget and in under six months. Now, they're finding out what nearly 7,000 other companies already know - that there's nothing like R/3 to get a better return on information and the maximum return on investment. With less than 1,000 days until the Year 2000, there's no better time for you to find that out than, right now. For more information visit our Year 2000 information center at www.sap.com/y2000. To get information on AcceleratedSAP for Year 2000, call 1-800-283-1SAP.



Enter Return On Information

CAUFIELD & BYERS
(Venture Capital)



WHERE IMMIGRANTS FIND MELTING POT OF GOLD

Foreign-born entrepreneurs run high-tech legends and spawn hundreds of startups

Entrepreneurial instincts finally got the better of Yuji Ide. After 15 years as a scientist with Toshiba Corp., he could point to 100 patents, including for the world's first digital still cam. But Toshiba was slow in bringing his inventions to market. "I was frustrated," says Ide, flipping through photos of prototypes that died in the lab. So in 1995 Ide took a radical step, for a Japanese: He moved to Silicon Valley and founded his own company. With \$6 million in venture capital—much of it from Toshiba—Ide's Cupertino (Calif.)-based Pixera Corp. has just launched its first product: a high-definition camera that connects to a PC. "I did this to be a very big electronics company," he says.

COLOR-BLIND. Immigrants have earned their big dreams in Silicon Valley. More than 100,000 technically savvy Indians, Chinese, Israelis, and Europeans keep the area at the forefront of global technology. Indeed, according to some esti-

mates, one-third of its engineers are foreign-born.

No other high-tech hub can match this vibrant, multinational talent pool. Where once there was a glass ceiling for foreign nationals, they now rise to the highest posts—from Hungarian-born Andrew S. Grove, CEO of Intel, to Algerian-born Eric Benhamou, head of

APPLIED MATERIALS HAS A UNITED NATIONS OF TOP EXECS

3Com Corp. "This place has become completely color-blind," says S. Atiq Raza, Pakistan-born founder of micro-processor design shop NexGen, which he sold to Advanced Micro Devices Inc. for \$620 million in 1996. "Everything here is driven by the need to succeed."

Such diversity gives Valley companies a global marketing edge, paying huge dividends. Applied Materials Inc., a \$4 billion chip equipment maker, has a veritable United Nations of top execs, representing Taiwan, Israel, Argentina, and India. Foreign managers of overseas units helped raise Applied's global market share from 6% in 1988 to 22% today, says Chief Executive James C. Morgan.

Foreign-born entrepreneurs are now spawning hundreds of startups, too, inspired by such successes as Soletron, S3, and Cadence—all co-founded by non-U.S.-born entrepreneurs. These pioneers have even developed their own venture following. Companies founded by Asian Americans have drawn most of the \$72 million that Alpine Technology Ventures has invested in the Valley. In June, Sequoia Capital started a similar fund with money from immigrants such as Benhamou and Alexandre Balkanski, founder of C-Cube Microsystems, which makes graphics-compression chips. Says Sequoia partner Michael Moritz, a Welshman: "We're determined to be the beacon for immigrants in the Valley."

The payoff of this investment surge is enormous. Hundreds of millions of dollars in foreign venture capital is now pouring into the Valley annually, showering myriad niches. Asians and Israelis, for example, shine in chip design, producing such companies as Cirrus Logic, NexGen, Trident, and ESS. All told, there are 1,500 Asian American-owned tech companies in the Valley, according to a study by investment bankers Hambrecht & Quist and University of California at Berkeley's Annalee Saxenian, author of *Regional Advantage*. The top 30 claim a market value of \$25 billion. So long as the boldest dreams continue to be realized and rewarded, the migration is bound to continue.

By Pete Engardio in Cupertino, Calif., with Peter Burrows in Palo Alto

The International Factor

NAME/COUNTRY	COMPANIES
ERIC BENHAMOU Algeria	Headed Bridge Communications, CEO of networking giant 3Com
ENZO TORRESI Italy	Co-founded retailer Businessland, server maker NetFrame, and Internet startup ICAST
PHILLIPE KAHN France	Founded software makers Borland International and Starfish Software
DADO BANATAO Philippines	Co-founded S3, Chips & Technologies, and other chip startups

TURNING PIP-SQUEAKS INTO PLAYERS

The IPO has done magical things for many startups, and its appeal is as strong as ever

It was 1993, and Halsey Minor was on the brink of bankruptcy. The 32-year-old founder and CEO of Internet media company CNET Inc. had maxed out his credit cards, was \$40,000 in the hole—and was ready to throw in the towel. “I was going to quit,” he recalls. “I had no more credit, and no one would give me any more credit cards.” Thanks to a last-minute cash infusion from a well-to-do friend, Minor escaped disaster, and his fledgling San Francisco-based operation survived.

And how. After CNET, with its snazzy delivery of computer and high-tech news, was rushed to the Web, it caught the attention of investment bankers. No matter that the startup lost \$3.7 million on revenues of \$1.7 million for the first quarter of 1996. In early July, the company went public—and into the welcoming arms of investors. Today, CNET has a market capitalization of \$403 million and Minor is sitting on a personal fortune estimated at \$72.9 million.

ULTIMATE HIGH. Almost anywhere else in the world, Minor's rags-to-riches tale would be extraordinary. But in Silicon Valley, where initial public offerings can transform paupers into princes and business seedlings into corporate redwoods, it's a way of life. Those three words—initial public offering—may be the most intoxicating in Silicon Valley. The IPO is the magical event that converts blood, sweat, and equity into cash—or at least publicly traded

shares. And for many entrepreneurs and the venture capitalists who fund their ideas, it's the ultimate high.

And not just because it pads their bank accounts. Selling stock to the public gives cash-strapped young companies money to finance expansion, build brand recognition, and gain a new currency that can be used to entice employees or acquire companies. That's more important than

ever in the age of the Net, where the goal is to get big, fast. Says venture capitalist L. John Doerr of Kleiner Perkins Caufield & Byers: “American capital markets are a national treasure.”

Treasure, indeed. Cisco Systems, Netscape Communications, and Oracle are legend for the legions of millionaires they have created. But how many millionaires are there at tiny Siebel Systems Inc., which before going public in June, 1996, used a folding table

for the CEO's desk? The answer: 700, almost a third of its 220-plus employees. Founder Thor

M. Siebel's 40% stake is in the sale



FRENZY *Most tech offerings go south. Still, “there are*

ormation software maker is worth \$8 million today. And there are scores of newly public companies just like it throughout the Valley.

The IPO is, to be sure, about money. But it's also a critical part of the delicate ecosystem that sustains Silicon Valley. How? The venture-capital firms and their investors make a bundle taking a company public. They pocket some of the money and plow the rest through those profits into the next generation of rising stars. Startups, meanwhile, use stock options to attract top engineering and management talent without having to lay out a lot of money up front on salaries. And when those options vest, it's not uncommon for employees to cash them in and use the proceeds to start their own companies. Or they may become angels themselves, investing in other tech startups.

HIGHFLIERS. With the stock market booming, many startups are skipping the later stages of private funding and heading straight for an IPO. Some 260 venture-backed high-tech companies went nationwide public in 1996, raising nearly \$12 billion. That's more than double the 117 IPOs in 1991 and more than triple the \$3.9 billion they raised, according to VentureOne Corp., a research group in San Francisco. Some of the highfliers in the IPO class of '96, including Yahoo! and Excite, were barely a couple of years old when they made their Wall Street debuts. Today, they account for a combined valuation of nearly \$1 billion.

What do these companies do with their newfound fame and fortune? One broker E*Trade Group Inc., whose employees danced into the wee hours the morning of a party following the company's successful 1996 IPO, used the \$3 million it raised to introduce new products and hire employees. It also went heavily to beef up its brand

name and keep pace in the fledgling market for Internet investing with such well-funded competitors as Charles Schwab & Co.

Netscape Communications Corp., which turned a \$5 million investment by Kleiner Perkins into a \$255 million windfall by the end of its first day of trading, has been on a two-year spending spree since raising \$148 million from its 1995 IPO. The Mountain View-based upstart has snapped up six companies and unleashed a barrage of new products to go head-to-head with software giant Microsoft Corp.

Two-year-old software maker BEA Systems went about things a little dif-

ferently. While still a private company, it leveraged \$50 million in venture funding from E. M. Warburg Pincus & Co. to buy up \$140 million worth of businesses. It then used the \$150 million it raised this year in the public markets to pay off the debt. The IPO "allowed us to buy the product and distribution and then to pay it off," says William T. Coleman III, founder and CEO of BEA. The unusual approach has paid off, too: BEA's sales have grown from \$62 million last year to \$30 million last quarter alone. Its shares have surged 283% since its April IPO.

Truth is, most high-tech IPOs go south. A study by Broadview Associates LLC shows that high-tech IPOs in 1996 lost 8.4% of their value, compared with the firm's broader tech index and the Standard & Poor's 500-stock index, which logged 11.5% and 22.9% returns, respectively.

With this sort of track record, it might seem that investors would sour on putting money into high-tech startups or newly public companies. Far from it. Venture-capital firms pumped a record \$6.3 billion into technology startups last year, according to VentureOne. And angels have become another major source of funding for fledgling companies. "There are dump trucks coming to Silicon Valley wanting to

pour the money in," says J. Neil Weintraut, managing director at 21st Century Internet Venture Partners.

DISTRACTIONS. They won't all hit pay dirt. One in three venture-backed companies is a complete flop—and right now even brand-new Internet markets are looking pretty crowded with contenders. Plus, there is another downside. Going public can tax a company's management resources and distract employee shareholders. "When the stock price goes down, they're depressed. And when the stock price goes up, they're euphoric," says Netscape co-founder Marc Andreessen.

That's why a growing number of companies are sidestepping the IPO process entirely, choosing instead simply to sell to one of the big players that are constantly scouring the field for promising new technology. Microsoft, for example, has spent more

The Valley IPO Boom: Top Performers ...

COMPANY	IPO DATE	OFFER PRICE	CURRENT PRICE	% CHANGE
RAMBUS INC.	5/14/97	\$12	\$66.5	450%
YAHOO!	4/11/96	\$13	\$54.87	322%
BEA SYSTEMS	4/11/97	\$6	\$23	283%

... And Worst

UNIFY CORP.	6/13/96	\$12	\$2.13	-82%
PRISM SOLUTIONS	3/21/96	\$17	\$4.62	-72%
ULTRADATA CORP.	2/15/96	\$10	\$3	-70%

FOR THE PERIOD FROM JAN. 1, 1996 THROUGH AUG. 5, 1997

SOURCE: BROADVIEW ASSOCIATES

ferently. While still a private company, it leveraged \$50 million in venture funding from E. M. Warburg Pincus & Co. to buy up \$140 million worth of businesses. It then used the \$150 million it raised this year in the public markets to pay off the debt. The IPO "allowed us to buy the product and distribution and then to pay it off," says William T. Coleman III, founder and CEO of BEA. The unusual approach has paid off, too: BEA's sales have grown from \$62 million last year to \$30 million last quarter alone. Its shares have surged 283% since its April IPO.

Don't be fooled, though. Not all IPOs are successes. Most are volatile, and some can be downright dogs. General Magic Inc., a once hot maker of communications software, went public in February, 1996, long before it was profitable. After peaking at 26% on the first

 For more on IPOs: See CNBC at 10 a.m. and 5 p.m. EDT on Aug. 14

dump trucks coming to Silicon Valley wanting to pour the money in"

than \$2.5 billion in the past four years on 57 acquisitions and partnerships. This year alone, it has acquired six companies, including the \$425 million purchase of Webtv, a two-year-old startup that makes a system for Web surfing from your tv. Meanwhile, disk-drive maker Seagate Technology Inc. made the founders of 15-month-old Quinta Corp. happy when it recently paid \$325 million for their company, which is working on next-generation disk-drive technology. Quinta had yet to

develop a product or earn one penny in revenue.

For those that want to go public, meager, even nonexistent, profits need not be a barrier. Netcom On-line Communications Services Inc. proved that, and it started a movement that hasn't let up. In 1994, the Internet service provider lost \$100,000 on revenues of \$12.4 million. Still, its December, 1994, IPO was a hit. The shares were priced at \$13, above their initial filing range of \$10 to \$12, and were soon trading at

over \$20—setting off a speculative frenzy around Internet stocks. These days Netcom shares trade in the mid-teens. After Netcom, says Weintraut, “I merely had to suggest you would be profitable in the future.”

Then came Netscape. When the company went public in August, 1995, it was just 16 months old and had put in \$16.6 million in revenues for the year or six months. Profits didn't come until later. Yahoo!, Excite, and CNET were all losing money at the time of the

CLOSE-UP

My Jet Is Bigger Than Your Jet

As a youngster growing up in Delhi, Samir Arora was always drawn to the U.S. “It was like a beacon attracting the entrepreneur in me,” he recalls. So without waiting to finish a degree in electrical engineering, in 1986 he set off for California to pursue his dream.

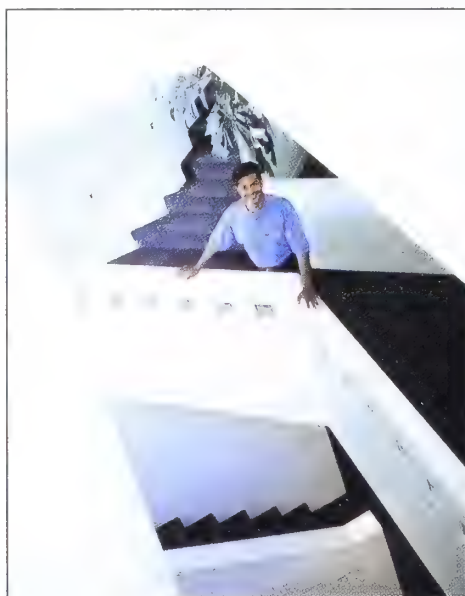
It was a rocky start: All of his belongings were stolen, and Arora spent six months bagging groceries before landing a job at Apple Computer Inc. In November, 1995, he founded Net-Objects Inc. By early this year, the Web software maker had burned through its funding and was on the brink when, in March, a bolt struck from the blue: IBM invested roughly \$100 million for a 50% stake—making 31-year-old Arora a multimillionaire. “It's the one-year instant success that took 10 years,” he jokes. “It's weird. You have to ask ‘Why is this happening to me?’”

PALACE, ANYONE? That question is cropping up a lot these days. A booming tech market and stock-option culture has helped swell the ranks of Silicon Valley millionaires by 45,000 since 1994, to 186,511 in 1996, according to Payment Systems Inc. The area now boasts one of the highest per-capita income levels in the country—\$32,548 in 1996 for the San Francisco Bay area, vs. a national average of \$24,324.

In the Valley's toniest neighborhoods, one might think money really does grow on trees. In Woodside, for example, where high-tech luminaries

such as Larry Sonsini and Scott Cook rub elbows with neighbors Neil Young and Riley Bechtel, “starter” homes begin at \$800,000. Most sell before they even hit the market, and buyers often plunk down cash, as Arora did for a sprawling \$2 million home in the Woodside hills.

Not far away, Oracle CEO Larry Ellison is building a \$40 million-plus



replica of the Japanese Katsura palace on 23 wooded acres. Presumably, he'll be parking his new Marchetti Italian jet fighter elsewhere—perhaps next to the aerobatic plane he just bought as an eighth-grade graduation gift for his son. In Atherton, Tom Proulx, a co-founder of Intuit, recently bought three neighboring lots so he could build a 9-hole golf course in his backyard. One Woodside

programmer bought 24 acres just to land his helicopter. “Keeping up with the neighbors in Silicon Valley is getting weird,” says Daniel H. Case III, president and CEO of Hambrecht & Quist Inc. “It's not, ‘do your kids go to private school.’ It's ‘do they have a private jet?’”

But for a surprising number of young, newly minted millionaires, wealth hasn't changed their lives much. There's simply no time for that. When Excite, a Net startup, got its first venture funding, the founders celebrated by going for ice cream at the local Denny's—then it was back to work. “There's just so much opportunity,” says co-founder Joe Kraus, “that you never get a chance to celebrate your successes.”

Even at Netscape Communication Corp., whose 1995 IPO unleashed startup fever, folks are, well, normal. Take Aleks Totic, a founding engineer. He figured that if Netscape was a wild success, he stood to make some money. But the real draw, says

Totic, was “fun coding.” Totic wrote a small check that bought him “a boatload” of Netscape shares.

**ARORA'S
“INSTANT”
SUCCESS TOOK
10 YEARS**

The IPO made Totic millions, yet he still lives in the Palo Alto apartment he shares with a roommate and drives the 1990 Integra he has had for years. When his options vest in four months, he'll likely stay on. “I don't see myself windsurfing for the rest of my life,” he says. Web surfing, maybe.

By Amy Cortese in San Mateo



[Second Place, Evolution]

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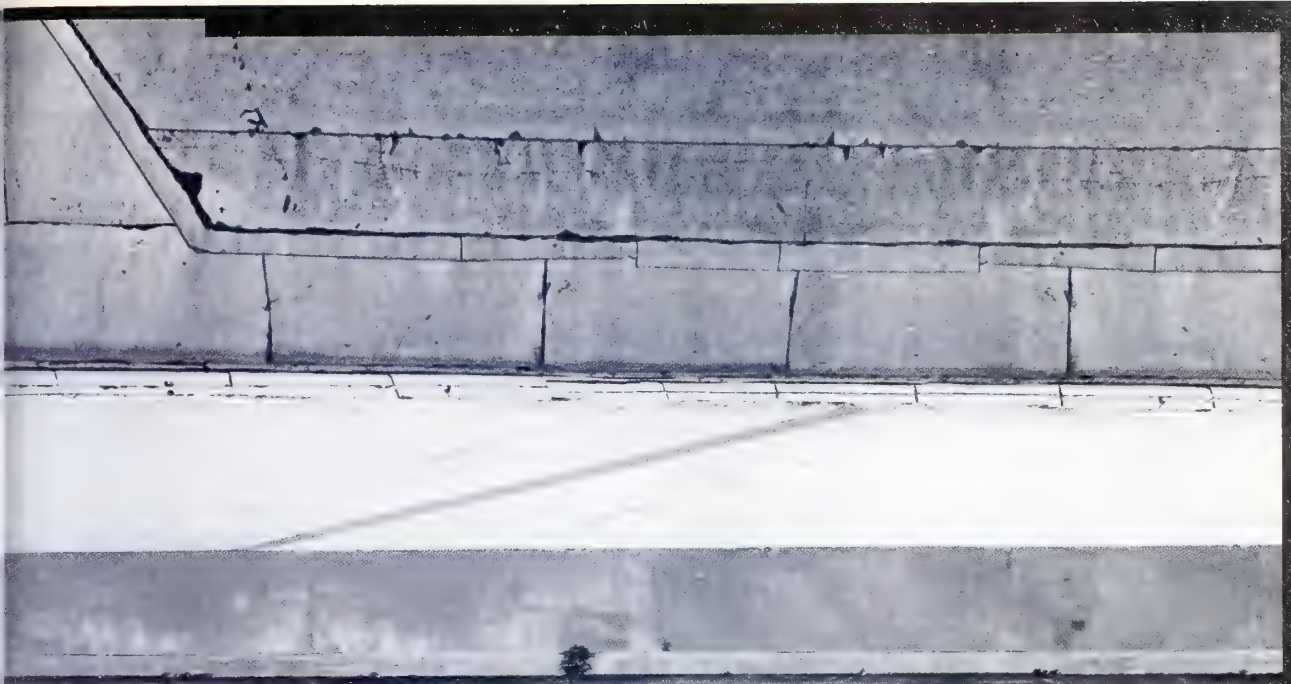
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If this were a data traffic problem, how would you solve it?

- (a) widen the alley**
- (b) send the dogs a memo asking for cooperation**
- (c) restrict walking privileges**
- (d) transfer dog walking responsibilities overseas**

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IPOs, too. Most Net startups still are—by design. CNET's Halsey Minor maintains that Internet media companies like his could see profits much more quickly than traditional media properties; magazines such as *Entertainment Weekly* and cable networks such as MTV have taken several years to turn that corner. However, he says, in the rapidly developing Web market, it's wiser to forgo profits in the short term to build up market share.

Investors are buying into the logic.

CNET's shares are up 62% from their IPO. E*Trade is up 184%. And some of this year's crop are sizzling, too. Despite continuing heavy losses, shares of @Home, a cable-based Internet service, have jumped 110% since its June 30 IPO. Shares of Rambus Inc., whose technology speeds computer performance, have surged a stunning 450% since May, making it the year's best-performing new offering. After Yahoo! turned in solid revenue gains and—gasp!—profits, investors have bid up its shares by

more than 300% in just 15 months.

Of course, there's always the old-fashioned way: build up a track record of revenue and profit gains before making the plunge into the public market. Some startups, such as Marimba and Crossroads Software, are doing that, and industry watchers expect a strong lineup of IPOs next year. If that's the case, the Silicon Valley market should keep humming along.

By Amy Cortese, with Linda Himmelstein, in San Mateo

CLOSE-UP

Even the Receptionists Are Millionaires

In 1993, Heather Beach walked into a crummy brick building in East Palo Alto to start a new, \$28,000-a-year job. She was going to be the receptionist for startup Siebel Systems Inc. At the six-person company, this meant everything from answering phones to ordering office supplies. The multiple assignments—and a \$7,000 pay cut from a previous job—did not seem to bother Beach, then 25 years old. After all, she was pursuing her goal: to work at an exciting new company where she had a chance of becoming a millionaire by age 30.

WISE RISK. Four years later, Beach has surpassed her wildest expectations. How did she do it? Like many of her colleagues, she elected to take a chunk of her paycheck in equity—on top of stock options she was already granted. So when Siebel, which makes sales-information software, went public in June, 1996, at \$17 a share and more than quadrupled in value by December, Beach's fortunes soared, too. For every dollar she took in stock instead of cash, she earned at least \$40, depending on the stock price.

Now, says a jubilant Beach, who spent a bit of her booty on rollerblades and a new bed, those who thought she was crazy for joining a fledgling operation are thinking again. "It's all about taking risk," ex-

plains Beach, who had written her college thesis on the virtues of employee stock ownership. "I wasn't going to say I wudda, I shudda, or I cudda."

Neither are the scores of secretaries, receptionists, office managers, and other support personnel who have cashed in on Silicon Valley's seemingly boundless prosperity.



Sure, the bulk of high-tech wealth rests in the hands of senior executives, entrepreneurs, bankers, and venture capitalists. But an increasing number of lucky, lower-level employees at such hot companies as Netscape Communications, Yahoo!, and CNET are benefiting, too. This is no small phenomenon, says Cisco Systems CEO John T. Chambers, who says 42% of Cisco's stock options are held by rank-and-file employees with an average gain of more than \$100,000.

But unlike many of Silicon Valley's high-profile big spenders, most working stiffly, such as Beach, don't run out to buy planes or lavish vacation

homes. Instead, they are putting their good fortunes into retirement accounts or education. Jennie Ahda for instance, is a 54-year-old receptionist for Netscape. She's using her windfall for a little travel and to help put her son through law school. Her one indulgence: a new BMW 525i. **36 STOCK SPLITS.** Then there are people such as 36-year-old Jennifer A. Overstreet. She was employee No. 35 at Oracle Corp. in 1983. She worked for more than 12 years as personal assistant to CEO Lawrence J. Ellison, starting out with an annual salary of \$18,000. In that time, Overstreet says Oracle grew from 2 employees to 24,000 and from \$5 million in revenues to \$5 billion. Her bank account

swelled, too, as stock options originally granted 14 years ago for \$5 became worth at least \$2,000 each,

thanks to some 36 stock splits.

Last year, Overstreet quit her job, opting to take some time for herself, get married next January, and fix up an 8,000-square-foot home in swank Pacific Heights. "For those people like me, in the right place at the right time, we did really well in an unbelievable way," says Overstreet, who plans to find a new job after the wedding.

Unbelievable as this sharing of the wealth may be, in Silicon Valley where millionaires are as typical as a sunny day, it's a fact of life.

By Linda Himmelstein, in San Mateo

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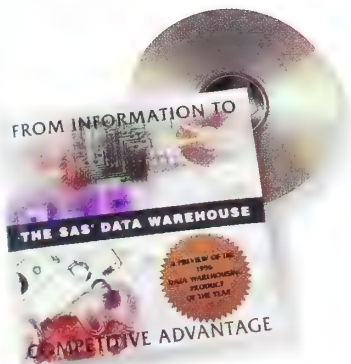
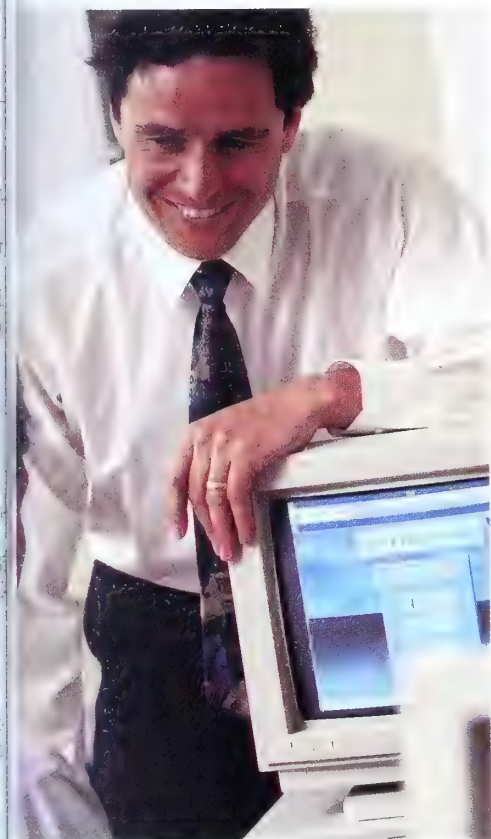
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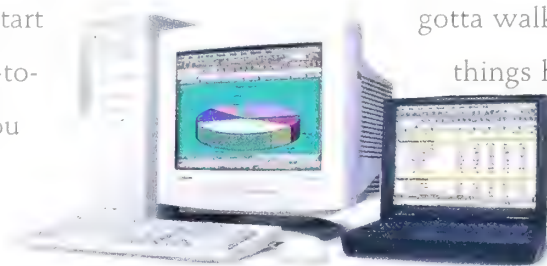
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TOO MUCH OF A GOOD THING?

Pricey houses. Labor shortages. Traffic jams. How success could choke the area's growth

For Harvey and Martha Moore and their four children, the Silicon Valley dream is a cruel mirage. They became homeless in March, after Martha's parents, with whom they were staying, lost their apartment to a 50% rent hike and moved to Manteca, 65 miles away. Harvey, 23, makes up to \$2,200 a month as a plumber, but they still can't afford a home anywhere in the Valley, where Martha grew up. Now, they feel lucky to have a small room at the Santa Clara Family Living Center, a homeless shelter housed in a former mental institution. Says Martha: "If it wasn't for this place, we'd probably be living in a car."

Despite the region's latest boom—indeed, because of it—stories like the Moores' are becoming too common. Their plight illuminates a surprising dark side of the high-tech dream. The longer the Valley booms, the tougher it gets for most people to live, raise a family, and make a business grow.

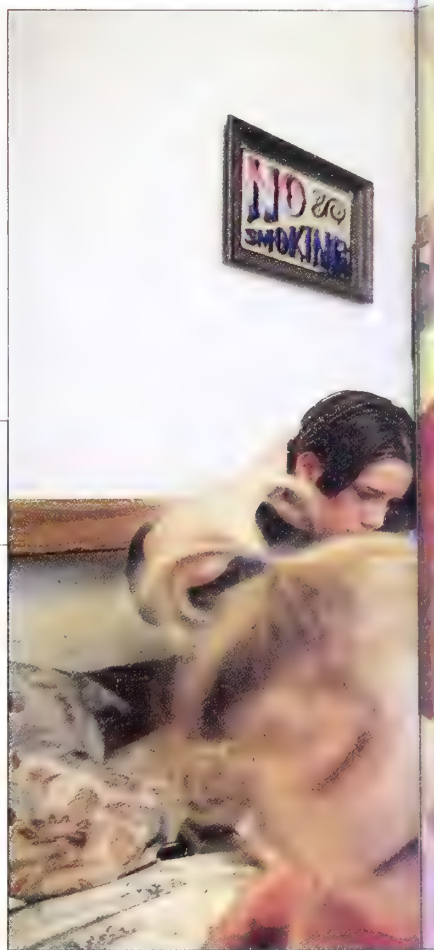
NO TRICKLE-DOWN. For many residents, the costs are simply too high in the Valley. Sure, a lot of tech workers get stock options. But for tens of thousands of plumbers, postal workers, janitors, and other lower-income workers, the Valley's vaunted wealth doesn't trickle down. Janitors, for instance, earn about \$8.40 an hour to clean the offices of chief executives making \$10,000 a day. Real wages for the lowest-paid 25% of workers here have dropped 13% since 1989, according to San Jose labor group Working Partnerships.

By contrast, money is the least of the business community's problems. Indeed, everything but venture capital is scarce: roads, office space, even good engineers and managers. Given the struggles of both residents and busi-

nesses, some leaders wonder how long the Valley can keep expanding. "You reach a point where the constraints just don't allow you to do more in the Valley," says James H. Clark, co-founder of Netscape Communications Corp. The quintessential success story of the Valley's current boom, Netscape is setting up operations in Austin, Tex., San Diego, and Seattle to avoid local overcrowding. Adds Halsey Minor, CEO of Net publisher CNET Inc.: "The Valley's a victim of its own success."

Nowhere is that more glaring for both individuals and businesses than in the housing crunch. The problem: From 1992 to 1996, the Valley added 125,000 jobs but only 26,000 housing units. The resulting crunch lifted the median price of a single-family home to \$319,000 in June, up 14% from a year earlier. That's out of reach for 70% of residents—and with undistinguished houses in Palo Alto bumping against the \$1 million mark, recruiters say getting talent to move here is very tough. Investment banker Sanford R. Robertson says he tried recruiting a banker from New York City recently. His wife "spent one afternoon with a realtor and the rest of the week-end crying" over sticker shock, he says.

The shortage has spread to rentals, too. Apartment rents shot up 20% last



year, and the vacancy rate is a scant 1.4%. One result: Some 20,000 residents will find themselves homeless at some point during the year, according to the Emergency Housing Consortium, a nonprofit shelter group. Santa Clara County supervisors recently started a housing trust fund, hoping to raise \$100 million for affordable housing. But that could take years.

GRIM PROSPECTS. Meanwhile, traffic congestion keeps getting worse. Delays in moving goods and people cost companies \$3.4 billion a year, according to the Metropolitan Transportation Commission. No wonder it's a sensitive topic: After the city of San Jose was sued for potential traffic problems at new offices for Cisco

THE DARK SIDE *Family life can suffer from the Valley's stress. This leads some companies to favor young, unmarried employees*



MARTHA MOORE, HER HUSBAND, AND THEIR FOUR CHILDREN LIVE IN ONE ROOM AT A HOMELESS SHELTER IN SANTA CLARA

tems Inc., the net-
king giant agreed
pay \$25 million for
d improvements.
Commutes are get-
g insane, too. For
er years, Bill Sweeney, a 41-year-old
er department maintenance worker
Redwood City, has commuted the two
rs it takes to drive 90 miles from
desto. That's the only way his family
four could afford a \$133,000 house
t he figures would cost \$350,000 in
Valley. But there's a toll, he says:
u get home and eat and shower and
e two hours before you hit the sack."
Prospects for improvement look grim.
te and federal funds won't cover the
3 billion needed through 2006 just to
p congestion from getting worse. So
nners are considering fees that would
l \$4 per square foot to the cost of
mercial buildings, and \$2,500 to the
ce of a home.
Meanwhile, commercial vacancy rates
from 17% in 1992 to 5% in 1996, and
nts say they're down to 3% today.
a result, it takes far longer to find an
ce than it does to find financing. Back-
b Technologies, an Internet software

startup, grew to 20
people before finding
space. For four months,
armed with cellular
phones and notebook
computers, employees
met in hotel lobbies and restaurants.
They slipped waitresses huge tips to let
them stay all day—and racked up \$3,000
a month in cellular bills. They eventually
found space in San Jose—but are already
bursting at the seams.
STRESSED OUT. For all the Valley's
overcrowding, its 3% jobless rate has
created a labor shortage, from mini-
mum-wage retail clerks to engineers
and top managers. Early this year,
PointCast Inc. delayed its planned initial
public offering to find a chief financial of-
ficer—only to wait even longer while it
now hunts for a CEO. "Finding great
people is one of the limiting factors to
growth in the Silicon Valley," says John
Danner, CEO of NetGravity, a Net-ad-
vertising software startup in San Mateo.
Given the explosion of jobs, Valley



**Reports on employee burnout,
CNBC real estate Aug. 14; overloaded
lives Aug. 15. At 10 a.m. and 5 p.m. EDT**

Distress Signals

► LOW-INCOME WORKERS

don't make enough to pay for basic expenses. A bare-bones budget for a single parent with two children in the Valley is \$28,000 a year, or \$15 an hour. But Valley janitors, for example, make only \$8.40 an hour.

► HOUSING

is scarce because job growth is outstripping housing starts. Since 1992, the Valley has added 125,000 jobs, but only 26,000 new housing units. The median price of a home hit \$319,000 in June, up 14% over a year ago. Apartment rents shot up 20% last year, while vacancy rates are a low 1.4% today.

► BUSINESSES

are having trouble finding space to grow. Industrial real estate vacancy rates are now less than 3%.

► TRAFFIC

is getting worse. In 1995, following a three-year decline, 15,000 hours were spent in freeway traffic delays during the average workday.

DATA: CALIFORNIA BUDGET PROJECT, JOINT VENTURE;
SILICON VALLEY NETWORK, CORNISH & CAREY COMMERCIAL,
CALTRANS

workers should feel more secure than ever. But at least 25% of new jobs are temporary or contract jobs—subject to layoffs at the first sign of a downturn. When chip-equipment maker Applied Materials Inc. downsized last year, for instance, it cut 7% of permanent employees—and half its temporary workers.

Then there's the toll the hypercharged atmosphere takes on personal lives. The stress on family life has led some companies, such as CNET, to the dubious policy of favoring young, unmarried people. Says Sun Microsystems Inc. CEO Scott G. McNealy: "It's really hard to do a startup with two kids at home."

Will any of these problems choke off the Valley's growth? James G. Treybig, founder of Tandem Computers Inc., worries that startups may find it tougher to grow into big industrial concerns here. "Silicon Valley is good for new ideas and new company formation, but it's not necessarily good to have a big company there," he says. Not the most promising trend for the region that's supposed to lead the global economy into the next century.

*By Robert D. Hof in Santa Clara,
with Steve Hamm in San Mateo*



Bartz is the only female CEO at a major tech company. "It's pathetic," she says.

WHY WOMEN ARE SO INVISIBLE

"You run into subtle sexism every day. It's like water torture. It wears you down"

When Carol Bartz was named chief executive of Autodesk Inc. five years ago, she joined the most exclusive of clubs. At the time, there was one female CEO of a sizable tech company in Silicon Valley—Sandra Kurtzig of Ask Computer Systems Inc. Now, Kurtzig is retired, and Bartz stands alone in big-tech-company circles. And she doesn't like it one bit. "It's pathetic," she says. "It paints a horrible picture of Silicon Valley."

And probably the last one people might expect. It shouldn't matter if you wear suspenders or a dress, least of all in the world's techno-epicenter, where the only price of admission is supposed to be smarts and hard work. But the numbers say otherwise: Among the Valley's 1,086 major tech companies, only

5.6% are led by women, according to CorpTech, a publisher in Woburn, Mass.

What gives? Is the supposedly wide-open Valley capped by a silicon ceiling? Blatant sex discrimination is rare, say women tech execs, but subtle barriers are encountered routinely. Anita Borg, a senior researcher at Digital Equipment Corp. in Palo Alto, calls it the "invisible-woman syndrome," where women's ideas are discounted or ignored. "You run into subtle sexism every day," she says. "It's like water torture. It wears you down."

But even if sexism were wiped out tomorrow, women still would be underrepresented in tech. The reason: Fewer women than men are

pursuing degrees in computer science. In 1984, 37.1% of such bachelor's degrees went to women, according to the National Center for Education Statistics. In 1995, that had shrunk to 28.4%.

For all the gloomy statistics, there are glimmers of change. In the past few years, as new companies surfaced, more female execs took the startup plunge. Last year, Kim Polese, a product manager at Sun Microsystems Inc., founded Web startup Marimba Inc. and then joined Babes in Boyland, an organization of female tech execs. "If you really want to shoot to the top," she says, "you probably have to start your own business."

CASH CRUNCH. And you may have to do it with your own checkbook. Despite a new crop of female entrepreneurs, women still have a tough time getting venture financing. Companies established or run by women received just 1.6% of the \$33.5 billion in venture capital invested in tech from 1991 to the third quarter of 1996, according to Venture One Corp. Just ask Janese Swanson, who produced software hit *Carma* in San Diego while at Broderbund Software Inc. In 1995, she founded Girl Tech, a San Rafael (Calif.) maker of electronic products for girls, but she had zip luck getting venture money and had to use her credit cards. "I went in with a debit card, a track record, and a stellar business plan showing a hole in the marketplace," she says. "Everywhere I went, I heard no's."

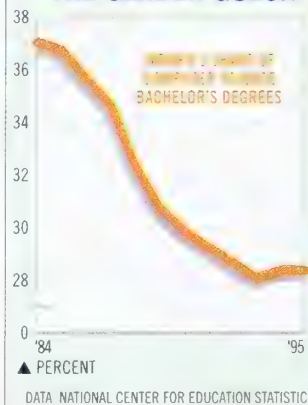
Some Valley companies are trying to correct gender imbalances. At Hewlett-Packard Co., Carol Mills and Jan Chaffin job-share as general managers of its multibillion-dollar Unix systems business. And Willem Roelandts, CEO of chipmaker Xilinx Inc., promoted two women who now report directly to him. "It's

a business issue," he says. "You can't ignore 50% of the brains in the world."

Still, profound social changes will have to take root before women receive their share of the Valley's rich harvest. Many young girls shy away from math and computers because they see them as a boy's province. That probably won't change for decades. "I don't expect Boys and Babeland anytime soon."

*By Steve Ham
in Palo Alto*

THE GENDER GULCH

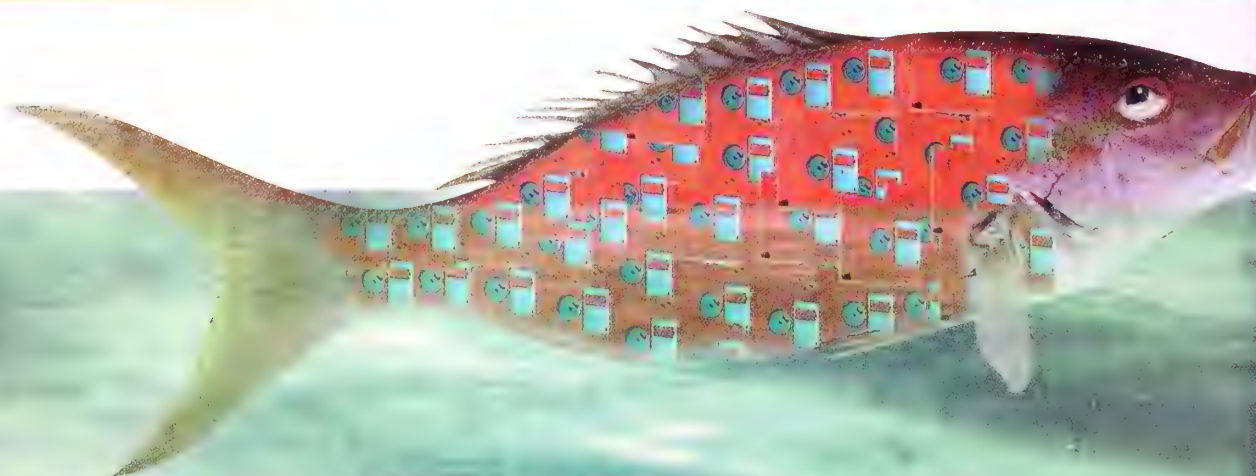


One of the Valley's most successful women, venture capitalist Ann Winblad: 10 a.m. and 5 p.m. EDT Aug. 11



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Glamour



IT MUST BE SOMETHING IN THE WATER

Many regions have tried to duplicate the Valley magic. None has succeeded

Illinois has long aspired to develop a flourishing high-tech community, something of a Silicon Prairie. And in 1993, opportunity pounded on the door. A group of computer science students at the University of Illinois' Urbana-Champaign campus developed the first browser with an easy-to-use graphical format for cruising the Internet. Even then, the browser, called Mosaic, appeared to have staggering potential. In the following four years, the online world would grow to 17.6 million people and the Net would explode into America's consciousness.

What exploded in Illinois was the chance to dominate the Next Big Thing in technology. The University of Illinois and Marc Andreessen, the lead Mosaic programmer, got into an ugly spat over rights to Mosaic. Silicon Graphics Inc. founder James H. Clark recruited him to Silicon Valley and together they founded Netscape Commu-

nications Corp., now the dominant Net browser company with a market capitalization of \$3.4 billion. The university tried to commercialize Mosaic through an existing Illinois company, Spyglass, but it has largely been squeezed out of the browser market and its market cap is a measly \$94 million. Don't expect Andreessen, whose Netscape stock alone is worth \$57 million, to help Illinois with big grants to his alma mater. "No contributions, no buildings, no nothing," he says. "They basically tried to shut us down."

So much for Silicon Prairie, or for a dozen other Silicon Valley wannabes in the U.S. and overseas. Time and again, other regions have failed to replicate the technological might—and wealth—of the world's high-tech capital. But it's not for lack of trying. Some thought the trick was to invest tax dollars in startups. The state of Illinois, for example, invested \$12.8 million

in 76 companies between 1985 and 1993 before abandoning the practice because of budget constraints and limited success. Others put their efforts into infrastructure—the state of North Carolina and local counties spent \$35 million on facilities for Research Tri-

angle Park. And then there has been the research-and-development approach. Bangalore, for example, plans to spend \$4 billion over the next five years on R&D. Heck, companies in New Jersey even hired Frederick Term, the Stanford professor who stressed entrepreneurialism and was dubbed "the father of Silicon Valley," to recreate the original.

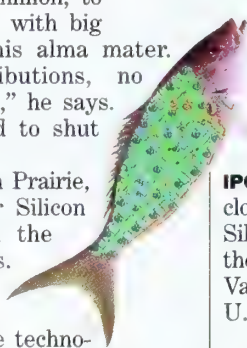
IPO POWER. But no region has come close. Despite all the efforts elsewhere, Silicon Valley stands skyscrapers above the rest. The numbers tell the tale: Valley claims 11% of all tech jobs in U.S., while representing just 1% of the population. And 25% of the globe's largest tech firms are housed there. As for the money rolling into tech, Silicon Valley cle-



**Boston
Route 128**

PCs? Never, thought the mini-computer town

Austin
Strong tech base but few local firms



**North Carolina
Research Triangle Park**

Little to show for government subsidies



Seattle
Microsoft money fuels startups

According to a 1996 study of 11 high-tech centers, including Boston, Austin, Raleigh-Durham, N.C., and Seattle, Valley boasted 75 out of 161 initial offerings for all 11 areas. The Valley took: \$2.9 billion, nearly half of the \$6 billion raised in the IPOs. "Every- is kind of dwarfed by Silicon Valley," says John P. Whaley, a partner in Minneapolis-based Norwest Venture

ING FLAT. Why are other regions to measure up? In a word: Monday, high-tech is a major economic driver—not only in sales of computer software and semiconductors, but use it's manned by high-paid knowledge workers. Per-capita income in the Francisco Bay area, for example, \$2,548 vs. the national average of

\$24,324. For American and foreign governments, that's attractive: There are more taxes to collect and none of the nasty waste of the steel or auto industries. "I get 500 visitors a year asking how the Valley works," says William Miller, a management professor at Stanford University.

The effort, however, is too often misplaced. Most attempts to build a high-tech presence fall to local governments, which can offer tax incentives or small investments but have no hand in inventing or commercializing technology. Research Triangle Park, for example, offers companies about one-third off their property taxes, amounting to some \$12 million a year. That has helped attract a solid community of researchers from big-name companies based elsewhere, no-

tably tech giants IBM and Cisco Systems and Glaxo Wellcome and Monsanto in pharmaceuticals. But entrepreneurs can't be bought with slightly lower real estate taxes: Local startups—with a few exceptions, such as SAS Software—are rare. "Research Triangle has looked promising for 10 years and it still hasn't panned out quite yet," says Richard D. Frisbie, managing partner at Battery Ventures in Wellesley, Mass.

Even private efforts to clone the Valley have fallen flat. Terman, the father of Silicon Valley, was hired in the 1960s to recreate the magic in New Jersey and Texas. He focused on establishing strong research institutions, like Stanford, that could provide a petri dish for bright ideas. But Terman was hired by large organizations, including Bell Labs

CLOSE-UP / TAIWAN

Taiwan's New Grail: Innovation

It looked like the coming of age for Taiwan's tech industry. In 1995, the country's Acer Inc. introduced a series of PCs that stood in stark contrast to the typical boxy, beige computers. Sleek and stylish, they came in slate black and merald green. Sales shot up 80% in the U.S., its most important market.

But Acer, like Taiwan, is just getting the hang of innovation. As the company's emphasis on form beyond function was imitated last year by Hewlett-Packard, Sony, and Toshiba, Acer tumbled to the 10th-largest U.S. PC vendor, from No. 7 in 1995. Other Taiwanese firms want to avoid Acer's missteps, but the country's government thinks the lesson is clear: The island's companies need to develop the creative gene, and fast. "We can't enjoy success forever if we are just a good, fast follower," says Steve Hsieh, former director general of Hsinchu Science-based Industrial Park. "The next stage is to develop our own technology



LI SET OUT TO BUILD A NEW VERSION OF STANFORD UNIVERSITY

through research." The Taiwanese government is trying to do just that. To foster more innovation, Taiwan is offering tax breaks and grants to push up national research spending from 1.8% today to 2.5% of gross domestic product by 2000.

Critical to the effort will be Hsinchu itself, a sprawling 1,430-acre technopark overflowing with electronics companies. Since its founding 17 years ago, Hsinchu has become the heart of Taiwan's technology industry, boasting 221 companies with 60,400 employees and revenues of some \$12 billion. That has helped to drive GDP growth to an annual average of 6.3% in the past five years.

through research."

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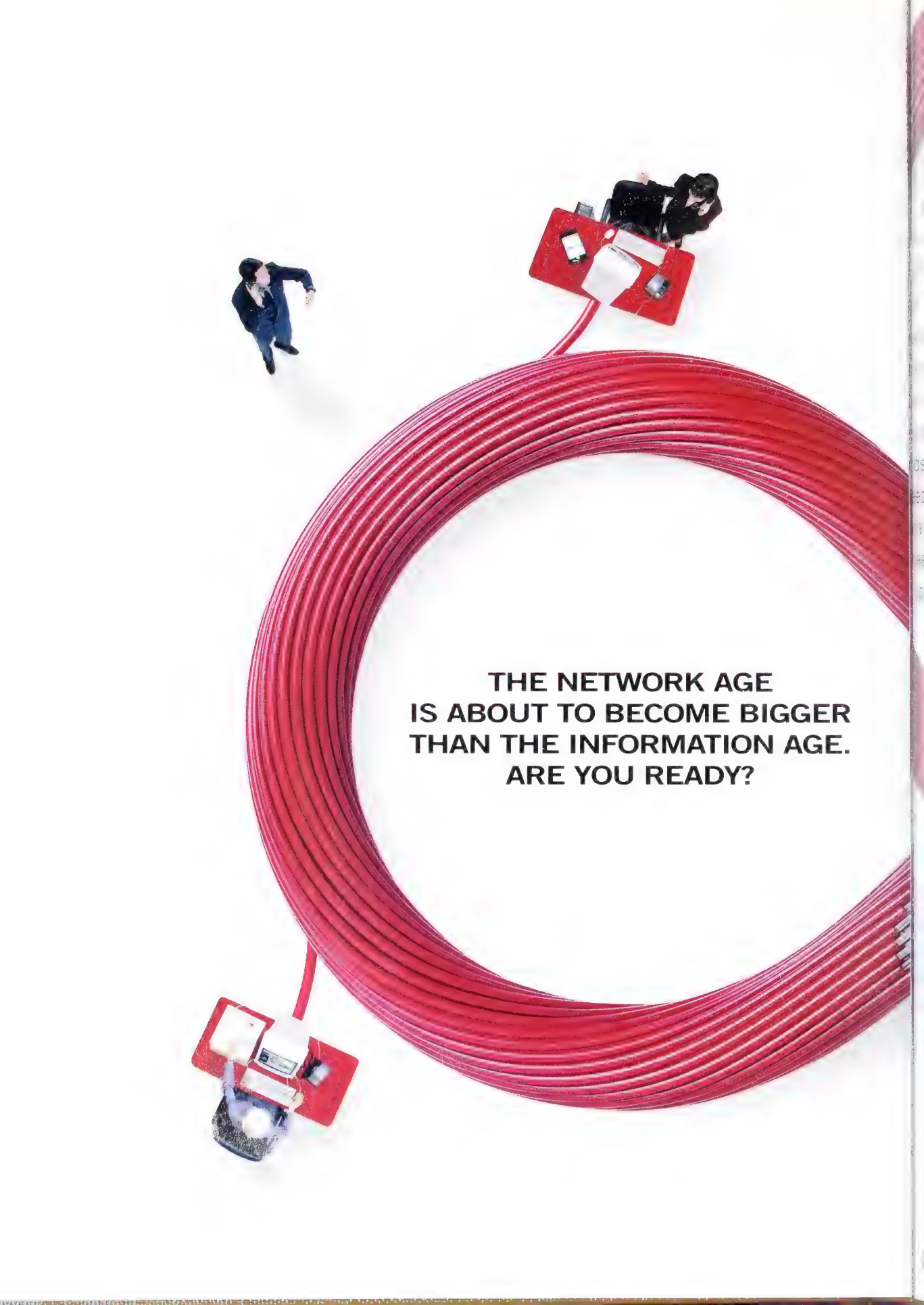
Critical to the effort will be Hsinchu itself, a sprawling 1,430-acre technopark overflowing with electronics companies. Since its founding 17 years ago, Hsinchu has become the heart of Taiwan's technology industry, boasting 221 companies with 60,400 employees and revenues of some \$12 billion. That has helped to drive GDP growth to an annual average of 6.3% in the past five years. The park's origins date back to 1973 when K. T. Li, then minister without portfolio, set out to build Taiwan's version of Stanford University. He used government money to

set up the Industrial Technology Research Institute (ITRI) with the mission of developing hardware and semiconductor technologies that could fuel startups. "I was very interested in the association of [Stanford] with the tech industry there," Li says. "We thought this could work in Taiwan."

STEEP PRICE. It has. Located in Hsinchu, ITRI has been responsible for some of Taiwan's most successful companies, including United Microelectronics Corp., now a \$1 billion semiconductor manufacturer. Success hasn't come cheap, though. Taiwan pays annual subsidies of \$420 million for ITRI and its sister institute for software research.

Some are skeptical that the government activism that helped build Hsinchu can now spur innovation nationwide. Given their success in manufacturing, a lot of companies are reluctant to spend heavily on research and development. "They are willing to spend money on improving production capacity, but not on R&D," says Chitung Liu, electronics analyst with SBC Warburg in Taipei. That formula has worked well so far, but competition from neighbors such as Malaysia and China could make that attitude as obsolete as yesterday's PC.

*By Jonathan Moore
in Hsinchu, Taiwan*

A large, thick red cable is coiled into a large circle that dominates the center of the image. At the top of the circle, a red desk with a computer monitor and keyboard is visible, with two people sitting at it. At the bottom of the circle, another red desk with a computer monitor and keyboard is visible, with one person sitting at it. A third person is standing to the left of the circle. The background is a plain, light color.

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COMPUTERS, COMMUNICATIONS, MICROELECTRONICS

and Texas Instruments Inc., and few company men were willing to chance a startup. "He failed, in part, because he overestimated the importance of academia and in part because he was hired by large companies with no entrepreneurial traditions," says Stuart W. Leslie, a professor of history at Johns Hopkins University, who recently completed a study on Terman's efforts.

CRITICAL MASS. Fostering an entrepreneurial spirit is key to the growth of any tech region. Unfortunately, it's not something that can be taught overnight. In the Valley, Terman's teachings in the 1930s helped launch Hewlett-Packard Co. in 1939. But it was decades before entrepreneurial-minded engineers would leave the computer giant for their own startups. Rohn Corp. was one of the first, and it wasn't launched until 1969 by M. Kenneth Oshman and three HP colleagues. What followed were another dozen HP offspring, including Apple Computer Inc. in 1977. "It takes time for an area to develop the infrastructure for startups," says Ted H. McCourtney, general partner at Venrock Associates, a New York-based venture capital firm. "Silicon Valley has a head start."

That counts for a lot. Today, the Valley has critical mass—in brainpower, in ancillary businesses such as components suppliers, and in the all-important financial backers. The economic advantages can be self-perpetuating, creating what some economists call "increasing returns." With so many tech players in one place, things work better—suppliers and customers can meet faster, info flows more quickly, new ventures are easier to launch. Success becomes a gravitational force, pulling in more people, money, and technology. "The existence of one industry center prevents the emergence of another center," says W. Brian Arthur, an economist at the Santa Fe Institute.

Does this mean other regions can't be big beneficiaries of the tech boom? Not at all. The industry added 240,000 jobs last year to a total of 4.3 million, thanks to big gains in Texas, New York, and Illinois, as well as California, according to the American Electronics Assn.

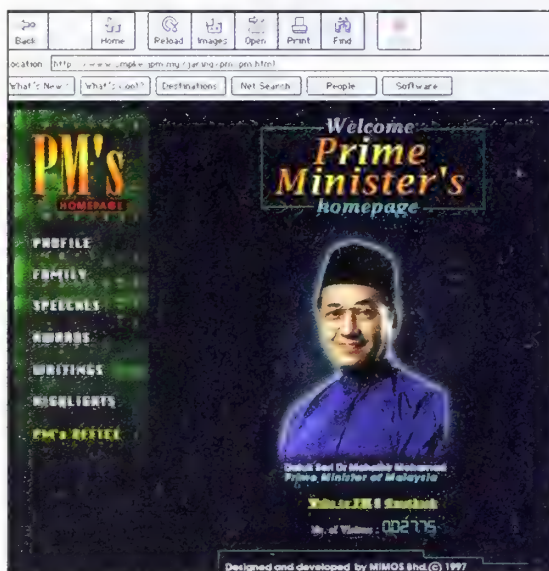
But other tech centers would do well to focus on areas that complement the Valley rather than come up against it. Boston ran into difficulties when local companies pushed minicomputers in the face of the PC revolution, but its strong university base has fueled recent successes in niches such as Internet security and data communications. Gateway 2000 Inc. turned North Sioux City, S. D., into a tech hotbed by using its low-cost

CLOSE-UP / MALAYSIA

Amid the Rubber Trees, A Multimedia Super Corridor?

Plans don't get much more audacious than the one to build a Multimedia Super Corridor in Malaysia. Consider this: Government officials need to scrounge up \$40 billion in a country where the

But Malaysia's elite are worried that simply being an electronics assembler won't be enough in an age where ideas create wealth. So Mahathir wants to use new technologies, government money, and tech



per capita income is just \$4,200. They must encourage the birth of tech startups in a land

where computer literacy and entrepreneurs are scarce. And if that weren't enough, they must lure global electronics companies, so that the result is a hothouse of technological activity—a sort of tropical Silicon Valley.

Sound a tad over the top? Not when you consider it is backed by Malaysian Prime Minister Mahathir Mohamad. When the physician-turned-politician took power 16 years ago, the country's economy pivoted on palm, rubber, and tin. Mahathir aggressively wooed Japanese and Western electronics makers, turning Malaysia into one of the world's largest producers of disk drives and other electronic components. Corporations such as Intel, Sony, and others have propelled economic growth to an annual average of more than 8% a year for the past decade.

MAHATHIR WANTS TO BUILD A TROPICAL SILICON VALLEY

ants to create a site beyond Silicon Valley. The bait: heavy government spending to make the 465-square-mile corridor a leader in using high tech in real-world settings. Mahathir is backing his pitch with 10-year tax holidays, work permits for foreigners, and duty-free imports of capital equipment. "Malaysia offers the Multimedia Super Corridor as a huge test bed," he says, "for trying out not just the technology but also the way of life in the age of instant and unlimited information."

VALUES. The boldness of the vision has won key support. Mahathir has attracted a who's who of the digerati onto his advisory board, including Microsoft's William H. Gates III and IBM's Louis V. Gerstner Jr.

Still, enormous problems lie ahead. Computer-savvy workers are hard to find. And while it desires the fruits of digital technology, Malaysia's elite fear that the Internet will usher in corrosive Western values.

Mahathir's focus has always been on big, easily definable projects, such as construction of the world's tallest buildings in Kuala Lumpur. If the economy remains strong, he should be able to get the corridor built. Still, Mahathir faces one of the toughest challenges in his career—trying to impose from the top an economic order that relies on creative bubblings from below.

*By Mark L. Clifford
in Kuala Lumpur*

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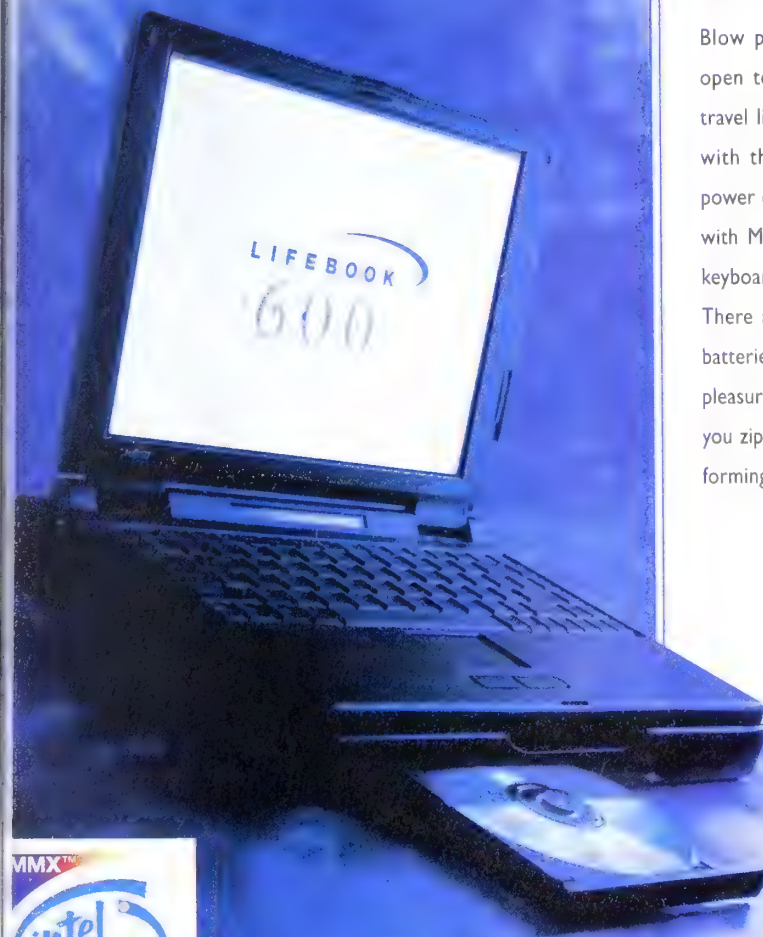
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Designed for



Microsoft
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workforce to make mail-order PCs. Overseas, Taiwan has taken advantage of its manufacturing expertise and low labor costs to carve out a niche in semiconductors and PCs. Ditto in New York, where the entertainment community used its expertise to build a respectable multimedia presence.

The one exception to all this: Seattle. The incredible might of resident Microsoft Corp., the No. 1 software maker, is drawing some of the brightest technical brains to the foggy Northwest. New York hedge fund manager Jeff Bezos migrated there to launch Web book-

seller Amazon.com. Microsoft alumni, such as Progressive Networks Inc. CEO Rob Glaser, are using gains from their stock options to fund new companies. And Microsoft Chairman William H. Gates III is pairing up with local wireless pioneer Craig McCaw to launch Teledesic Corp., a \$9 billion satellite system for worldwide data connections.

Does that mean Silicon Valley's lock on the tech industry is not absolute? You bet. Tectonic shifts in technology offer opportunities for new companies and regions to take the lead. Led by Digital Equipment Corp., Boston

usurped New York's tech crown with minicomputers overwhelmed IBM's mainframes. "There has never been a region yet that has been able to sustain advantage," says historian Leslie.

The trouble for the Valley's imitators is that the most significant tech shift the 1990s looks to be the rise of the Internet. And thanks to Netscape's C and Andreessen, the Valley already staked a big claim in cyberspace.

By Peter Elstrom in New York, Paul M. Eng in Raleigh, N.C., F. Judge in Boston, and Gary McWilliam in Houston

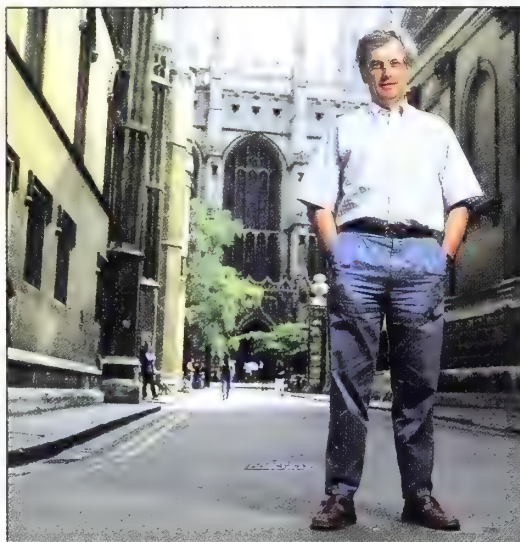
CLOSE-UP / CAMBRIDGE

The Hallowed Halls of Homegrown Tech

It was a triumphant moment. On July 18, Ionica PLC founder Nigel Playford and a few colleagues huddled around a computer screen, watching Ionica's stock on its first day of trading. Within minutes, investors had turned the six-year-old telephone company that competes with British Telecom into Cambridge's first business with a market capitalization of \$1 billion. Playford broke out the bubbly. "Cambridge is one hell of a good place to set up a company," says the 41-year-old.

He's not the only one who feels that way. With a cluster of 1,200 technology companies, the ancient market town of Cambridge is becoming one of Europe's hottest high-tech centers. Although the average company has only 12 employees, on a collective basis they are credited with creating 35,000 jobs and pushing regional unemployment levels down to 3.5%, far below Britain's national average of 5.7%. "Cambridge is going to be one of the real engines for growth within Britain and Europe," says David Cleavelly, managing director of Analysys, a Cambridge telecom consultancy.

It's already happening. Local companies are flourishing in a broad range of tech fields, including multimedia software, networking, and



wireless communications. Many are spawned by ideas from Cambridge University. Stewart Lang, a computer-graphics researcher at the university with one startup success already, has launched Autostereo Systems to commercialize technology that makes an image on a screen look three-dimensional by showing it from 28 different angles. And Acorn Computer Group, launched by Cambridge graduate and super-entrepreneur Hermann Hauser, is one of the first designers of network computers, low-cost terminals that access the Net at high speeds.

Already, Cambridge's homegrown tech companies boast combined annu-

**AUTOSTEREO
SYSTEMS'
LANG IS A
CAMBRIDGE
RESEARCHER**

al revenues of \$2.5 billion. Add sales from the global technology companies that have invested in the area, such as Nokia, and that figure doubles, to more than \$5 billion. Xerox, Olivetti, Oracle, Hitachi, and the Stanford Research Institute have set up Cambridge "listening posts" to get access to research that comes from the university's labs.

NO IMITATIONS HERE. The most recent arrival is Microsoft Corp., which announced in June it would invest \$80 million for a Cambridge research lab. Microsoft also is investing \$16 million in a new venture-capital fund run by Hauser, who has started or co-founded about 25 companies in the Cambridge area, including semiconductor research company Advanced RISC Machines.

For all its tech success, though, Cambridge doesn't see itself as a Silicon Valley clone. "People sometimes use the expression 'Silicon Fen,'" to describe what's happening here, says Roger Needham, a Cambridge University computer scientist who was recruited to head Microsoft's new Cambridge lab. "But I object to that term. Cambridge doesn't imitate anything, thank you."

The university town also eschews Silicon Valley's more blatant materialism. Even some of Cambridge's most powerful players prefer to pedal to work each day on beat-up bicycles. Although Cambridge has become a hotbed for high-tech startups that doesn't mean it's shedding its centuries-old traditions.

By Julia Flynn in Cambridge



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COMPUTERS, COMMUNICATIONS, MICROELECTRONICS

CLONING THE BEST OF THE VALLEY

Much of what makes it great can be applied to companies of all stripes

The secret to Silicon Valley's success isn't in the silicon. It's not the speedy chips or the whizzy computer games or the intricate data-mining software that can sift complex databases to let us know that beer and diapers are the two items most often purchased together after 6 p.m. It's not even the omnipresent Web addresses that assault us on TV, in magazine ads, and on billboards. Rather, it's a way of doing business. Says venture capitalist L. John Doerr, of Kleiner Perkins Caufield & Byers: "It's a network, as opposed to a hierarchy."

Silicon Valley is setting a new standard for the way all businesses—not just high-tech companies—are run. With their flatter, more democratic organizations, giant talent pools, enormous web of interlocking relationships among companies, super speed, and can-do culture—especially the can-do culture—Valley firms are changing the rules of management.

But not enough. Elements of the Valley have been copied, but the place has not been cloned, gene for gene, anywhere in the world. And despite the corporate rhetoric and modest changes—fewer levels of management, shorter product cycles, even casual dress—the business world at large still doesn't get it. Says Intel Corp. CEO Andrew S. Grove: "People talk the talk. But when I go to the airport and see two dozen Gulfstreams, I don't know if companies have really figured it out."

They haven't. So here's a short list to help.

Failure is O.K.—seriously. Reward those who take risks, and don't penalize those who take a chance and fail. In other parts of the world, business flops and dead-end projects are stigmas. Careers screech to a halt. That makes managers afraid to take a gamble. It's

not that way in the Valley, and not just for twentysomething entrepreneurs.

Push all levels of management to try new ideas. "The tolerance of failure is an intensely positive thing that people can learn from and apply," says Larry Keeley, president of Doblin Group, a consulting firm. That's why venture capitalists don't mind backing entrepreneurs who have had a couple of flops. Just ask Nolan K. Bushnell: He's started more than 20 companies, including gamemaker Atari Corp. More than half of his ventures have been disappointments. Says Jean-Louis Gassée, founder of computer startup Be Inc.: "It's hard to learn when you succeed."

Let ideas incubate. Valley companies excel at the early, often muddy stages of a business. This is partly because of the freedom-to-fail culture and a willingness to take greater risks when ideas are still unfolding. The key is to give the ideas breathing room. Don't require a 20-page business plan and detailed market research for every interesting notion. The laptop computer market would never have come about if someone waited for the market research suggesting that consumers want mobile computers. "This is a place that grows out of the rubble of the old innovations," says Paul Saffo, of the Institute for the Future.

Learn to live with creative chaos. Silicon Valley isn't just about speed and shortening product cycles. It's about developing a culture that can adjust quickly to change and chaotic environments. That means teamwork, coordination, minimal bureaucracy, and authority pushed down into the ranks. Indeed, the odd thing about Silicon Valley is that people are fiercely individualistic and yet quick to collaborate, share ideas over E-mail—anything to get the job done faster.

Be your own toughest competitor. Sil

icon Valley is an environment so accustomed to fierce competition that companies hunt for their own soft underbelly. That means coming up with better products that kill off your existing ones—practice known as "eating your young." Says Alan F. Shugart, chairman of d



the giant Seagate Technology Inc.: "Sometimes I think we'll see the day when you introduce a product in the market and announce its end of life at the end of the day."

Don't stick with your starters too long. A lesson has been learned the hard way. Not every entrepreneur does everything well. The characteristics needed for startup—zeal, unwavering belief in a mission, and perfectionism—can make more mature companies. In the Valley, you can count on one hand the founders still running their billion-dollar businesses. So when a company or a business grows to a significant size—say, \$1 billion—get seasoned help.

Spread the wealth broadly. Put in place compensation systems that reward performance—for all employees, not just those at the top. The Valley's liberal stock options and vesting programs have become the reason why its employees work at Net speed. So stoke

BENCHMARK *There are steps you can take to foster a flourishing environment, but the business world at large still hasn't caught on*

the money machine. Making people rich, fast, is what keeps the food chain filled. This creates a natural pool of managers, or so-called angels, ready to use their bankroll to fund the next great idea. Says James G. Treybig, founder of Tandem Computers Inc.: "This is an awesome machine to create new companies."

Grab market share at all costs. Even if it means giving your product away. And in the process, change the rules of the game. That's what Netscape did. Use the Internet to cut out the middleman and go direct around the world. It's great

for building market share and brand recognition. This also tightens relationships with customers and changes the balance of power in the world of distribution. Net media and Web search engine companies such as CNET Inc. and Excite are doing just that—much to the frustration of traditional media companies. By jumping on the Net early and keeping their services free, they've captured market share and established well-known brand names on the Web.

Stay at the cutting edge by investing in startups. The best way to get innova-

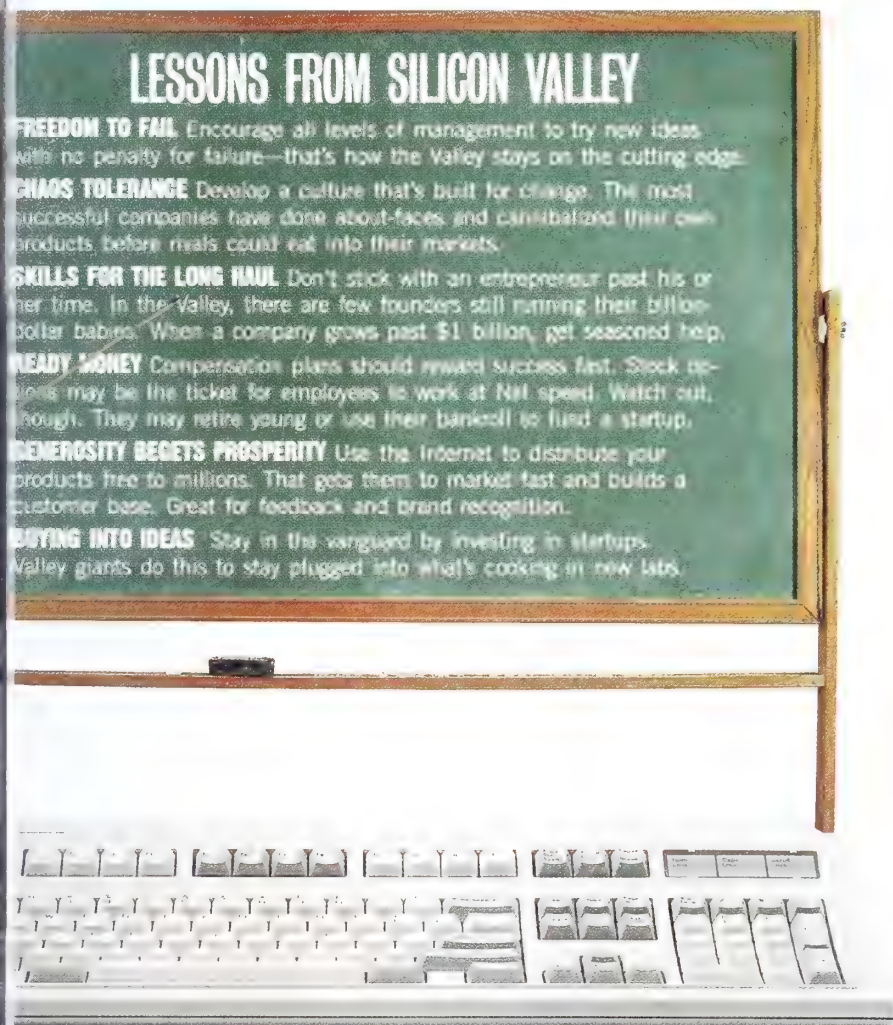
tion may be to buy it. Giants like Cisco Systems Inc., which has bought or invested in 34 startups in the past three years, do this to stay plugged into what's brewing in the labs of new companies. Chip king Intel has a \$500 million investment fund it uses to seed startups, particularly in the Net and content areas.

So set up a venture capital fund and bring in your own dealmakers to connect with small, fast-moving companies in your industry. Later, you could either make a killing when they go public, get a jump on some new technology, or resell their product, lowering research and development costs.

In the end it comes down to that ill-defined, yet critical ingredient: culture. You can change it but not by picking just one or two items from this list. You have to change the way you do business. And remember the first item: Failure is O. K.

By Ira Sager in New York, with bureau reports

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SOROS: His Quantum fund showed a 27.1% gain through July

INVESTMENTS

THE RICH GET A LITTLE RICHER

But hedge-fund players still trail the S&P

Most rich people who invest their millions with the biggest hedge funds are lots happier than they were just a month ago. But they're still not as happy as working stiffs who stick their hard-earned retirement savings in a mutual fund tied to the Standard & Poor's 500-stock index.

After a first half that ranged from poor to lackluster by hedge-fund standards, the so-called macro funds, which make leveraged bets on stocks, bonds, commodities, and currencies, rebounded with a vengeance in July. The improvement resulted from a number of developments, including big gains in large-capitalization U.S. and European stocks, a surge in Russian and other emerging-market investments, falling U.S. interest rates, and the strengthening of the dollar against the yen and European currencies. But a key con-

tributor was the funds' speculative plays on the Thai baht and other struggling Asian currencies, such as the Malaysian ringgit and the Philippine peso.

Yet even with the boost from the plunging baht, some of the world's most famous funds, notably Julian Robertson's Tiger funds and George Soros' Quantum Fund, trailed the S&P index, which is up 30.2% through July 31. (In March, Robertson initiated a libel lawsuit in New York State courts against *BUSINESS WEEK* arising out of a cover article that appeared in the Apr. 1, 1996, issue. The complaint has not yet been served.) Robertson declined comment. A spokesman for Soros declined to comment on investment strategy.

Referring to the hedge funds as a group, George P. Van, chairman of Nashville-based Van Hedge Fund Advisors, says: "They're in the third year

The Hedge Funds: A Summer Bounce

FUND/ MANAGER	(PERFORMANCE % NET AFTER FEES)		
	1996	1/1/97-6/30/97	1/1/97-7/31
QUANTUM FUND George Soros	-1.5%	14.0%	27.1
JAGUAR FUND Julian Robertson	39.9	0.7	11.7
OMEGA ADVISORS Leon Cooperman	37.1	18.0	24.1
ARGONAUT PART. David Gerstenhaber	38.7	10.4	23.2
Macro Average	14.6	10.3	19.1
Hedge Fund Index	18.6	9.1	13.4
Standard & Poor's 500 Stock-Index	22.0	20.6	30.2

*Estimated

DATA: BUSINESS WEEK, BLOOMBERG FINANCIAL MARKETS, VAN HEDGE FUND ADVISORS

of a marathon in which they're trying mostly unsuccessfully, to beat the S&P. Although aggregate performance data aren't yet available for hedge funds through July, Van and other fund traders say that most types of funds posted sharp gains in July but that all categories will likely continue to lag behind the S&P when the final returns are in. An estimated 4,700 hedge funds around the world manage about \$225 billion of investors' capital, Van says.

The big losers: funds that specialize in selling stocks short, showing again that you can't fight a raging bull. According to Van, the shorts lost 9% in 1996 and have gained zilch through June.

BIG BETS. In the case of Tiger Management, the world's second-largest hedge fund company, with \$10.5 billion under management, short positions in the biotech sector, which has depreciated 28% since its 1992 devaluation, have helped make the difference between a poor year and a mediocre one. The firm's largest fund, Jaguar, posted a net gain of 11% through July 31 after a gain of 0.7% for the first six months of the year. The fund scored a spectacular 40% return last year, as big bets on U.S. stocks paid off. A person familiar with Tiger's performance said that as Robertson turned bearish earlier this year, Tiger converted some equity holdings to cash and added to its short positions.

George Soros, who has been attacked by Malaysia's Prime Minister Mahatma

IS THIS LENDER TOO HUNGRY FOR ITS OWN GOOD?

Critics say Cityscape pushes loans on those too poor to borrow

Making big profits by lending to families with small incomes. That has been a winning formula for a sizable band of mortgage lenders who, enticed by fast growth and rich margins, cater to the so-called subprime market.

Perhaps the highest flier is Elmsford (N.Y.)-based Cityscape Financial Corp. Revenues have jumped from \$49 million in 1995 to \$199 million. Since 1995, it has securitized and sold some \$2.7 billion in loans, mostly home equity ones. Its stock, up 36% in 1994, reached a high of 36% last year (chart, page 150). Investor P. Michael Price, president of Short Hills (N.J.)-based Franklin Mutual Advisors, paid about \$80 million last January for a 14% stake.

But Cityscape's heady days of rich profits may be numbered. On Aug. 4, Moody's Investors Service, for the second time

this year, downgraded Cityscape's senior debt, from B1 to B2—largely because of questions about its loan delinquencies. Moody's analyst Thomas Foley questioned not only the high level of delinquent loans 90 days or more overdue but also the company's failure to foreclose or charge off overdue loans. Its stock is now trading at 13%.

RISING COMPLAINTS. Cityscape CFO Tim Ledwick responds: "We don't necessarily agree with the reasons why Moody's downgraded us. Since we've been enhancing our operations, we've been addressing their concerns. We still believe fundamentally the business is very strong."

Problems in Cityscape's mortgage loan portfolio are reflected in rising borrower complaints in the U.S. and especially in Britain, where Cityscape received over

CREDIT RISK

Although recently bankrupt, the Belchers were lent \$85,000 at 17.9%. Chaos followed



amad for his currency plays, saw his hip Quantum Fund gain 27%, after through July 31, almost double the gain achieved in the first half of the and a sharp improvement over last's dismal 1.5% decline. And Soros' a Fund, an equity and macro fund uses outside investment advisers, ed 70.3% through July, up from 50% e first half, according to Soros Fund agement.

ER LOSSES. In recent weeks, the ines of Soros, Tiger, and other big ers took a sharp turn for the better e Thai government gave up trying rop up its beleaguered currency, acing to hedge-fund, trading, and govenent sources in the U.S. and Asia, t of whom requested anonymity.

June, when the Thai government erated its intent to maintain the of l value of the baht at around 26 to dollar, the big hedge funds were ing up paper losses on their cury short positions, if not their equity t positions. But as the futility of effort became apparent, the Thai ral bank surrendered on July 2, and baht plunged 18% overnight.

eanwhile, other, smaller hedge funds a short positions in the baht and stocks had already bailed out, preing to take smaller profits earlier. example, Argonaut Capital Manent, which oversees about \$100 on in assets, liquidated most of its t positions in the baht and Thai ks in June. Says President David stenhaber: "I didn't have positions ctured in a fashion that gave me confidence to maintain them, given uncertainties of what the Thai autities were doing." The Asian cury play, he says, was "not a meanul contributor to July performance." o be sure, Asian currencies were not only spark for the impressive July s at the macro funds—or other fund gories, for that matter. Tiger is said ave benefited from its holdings in , Intel, and Citicorp. Additionally, the Hennessee Group, a hedge-fund sory firm: "Most international manrs were overweighted with substantial tions in European stocks" hedged nst declines in European currencies. onaut, for example, attributed its % gain through July (vs. 10.4% ough June) to holdings in large-cap opean exporters such as Volkswagen, L. M. Ericsson and U.S. multinaals, including Coca-Cola, IBM, and GE. With their stellar July behind them, hedge funds are surely hoping their summer dream lasts. But even if it s, they may still be hard pressed to t the working stiff.

by Phillip L. Zweig in New York, a bureau reports

“Getting a Cityscape loan is like walking into quicksand....”

— P. MICHAEL ANDERSON, the Belchers' attorney

50% of its profits last year on 26% of sales. CMC, its British subsidiary and the largest player in the mortgage subprime market, has been under press scrutiny for aggressive lending practices, such as high early redemption fees. John Bridgeman, director of the British Office of Fair Trading, says such loan practices are “deceitful and oppressive.” On July 14, Paul P. Flynn, a Labour member of Parliament, called for CMC's operating license to be revoked. And some 400 borrowers who claim they were abused by CMC are exploring a class action. Cityscape CEO Robert Grosser responds: “Everything we did in the U.K. was legal, and many other lenders charged early redemption fees as well.”

TROUBLED RIVALS. Many analysts and investors continue to support Cityscape. “My outlook hasn't changed,” says Ray Garea, Franklin Mutual's senior vice-president. Others have become wary. “Cityscape is taking an increasing amount of risk to generate substantially lower returns,” says Tom Fasiola, an analyst with Lehman Brothers Inc. “I really doubt this company's long-term ability to survive.” Says Grosser: “We feel very strongly about our products, our underwriting is very prudent, and we feel this will lead to longtime rewards for this company.”

Cityscape isn't the only subprime mortgage company with troubles. Last year, the industry sold \$27 billion worth of home equity loans, mostly subprime—twice the 1995 figure. W. Criss Peters, a vice-president in structured finance at Moody's, says: “If you look at foreclosure rates, you can see they're skyrocketing.”

Some analysts see parallels with the subprime auto-loan industry. Last January, the stock of Mercury Finance Co., one of the biggest players, dropped from 14% to 2% in two days after disclosure of overstated earnings and failure to adequately disclose loan losses. “I've seen this movie before, and I know how it ends,” says Fasiola, referring to many subprime mortgage companies.

Unlike the auto-loan business, subprime mortgage firms rely mainly on brokers to generate

loans. Various loans sold to Cityscape have been suspect. Grosser contends that some of the \$130 million in loans Cityscape acquired from Parsippany (N.J.)-based Walsh Securities Corp. were fraudulent. Some independent brokers whose loans were financed by Walsh are being investigated by state and federal authorities for alleged mortgage fraud. “The amount of questionable loans Cityscape bought were diminutive,” Grosser responds. “And Walsh has always lived up to their agreements, which would require them to repurchase any loans which turn out to be fraudulent.”

One of Cityscape's major brokers is Jericho (N.Y.)-based Coastal Capital

Corp. Chairman Mitchel Gale is the former credit manager for a New York mortgage company called the Dartmouth Plan, founded by Gale's father, Mel. A 1993 report by the New York Consumer Affairs Dept. termed Dartmouth “the granddaddy” of “equity scams.” A division of Dartmouth folded in 1990. The rest of the company became Resource One, which now sells loans to Cityscape. Says Mitchel Gale: “Coastal Capital is not an extension of the Dartmouth Plan... I run a clean business.” Grosser says Coastal Capital and Resource One are completely reputable.

In the past two years, Cityscape bought \$65 million in loans from Broker Capital Credit Ltd., according to owner Tony Murtagh. Murtagh was a director of his father's mortgage company, Rich Murtagh & Co. In 1989, the company's license was revoked “because of deceitful and oppressive practices.” Tony Murtagh declined comment. Grosser says: “We have a qualification process; the company obviously passed it.”

When they took out a home equity loan financed by Cityscape in 1991, Mamie and Grover Belcher were oblivious to the company's background. The poor, medicare-disabled Mount Vernon (N.Y.) couple were just coming out of bankruptcy in 1991 when a home improvement company persuaded them to take an \$85,000 loan at 17.9% despite their low “D” credit rating. The Belchers never received a truth-in-lending statement and didn't understand the cost of the loan, according to the lawyer, P. Michael Anderson. Lenihan & Anderson in West Plains, N.Y. “Getting a Cityscape loan is like walking into quicksand, and they just let them sink,” he says. In 1992, a bank initiated foreclosure proceedings. The Belchers are suing Cityscape for usury and fraud in a case expected to go to trial later this year.

Grosser says the Belcher case is unfortunate but not indicative of the company's overall loan quality. Whatever the merits of the suit, high-flying Cityscape continues to lose altitude.

By Debra Sparks in New York

A HIGHFLIER'S TROUBLES...

1985 Cityscape Financial incorporates as a mortgage lender.

1994 It goes public via reverse merger with Mandi of Essex, a shell company.

1995 Company and British partners form Cityscape U.K., known as CMC. Engineers a rapid expansion.

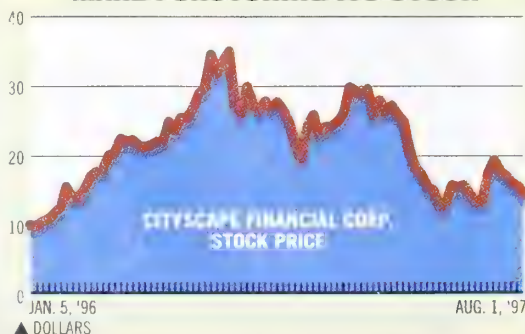
JANUARY, 1997 Investor Michael Price acquires 14% of company for about \$80 million.

JULY Britain's Office of Fair Trading says industry loan practices are “deceitful and oppressive.” A group of 600 borrowers who claim they were abused by CMC explore a class action. A member of Parliament calls for CMC's license to be revoked.

AUGUST Moody's announces a second 1997 downgrade on company's senior debt, from B1 to B2. Analyst questions high level of delinquent loans and failure to foreclose or charge off overdue loans.

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MERGERS

SPECULATION 101: A CHASE-MERRILL DEAL?

Wall Street is abuzz. Here's what a combo could look like

Deal of the century? Banks such as Bankers Trust New York Corp. and NationsBank Corp. are snapping up securities firms. And that has sparked a fair amount of speculation on Wall Street about whether Chase Manhattan Corp., the nation's largest banking institution, and Merrill Lynch & Co., which has the country's largest brokerage network, might get hitched. Such a pairing would dwarf most rivals. Based on current market and yearend 1996 figures, a combination would have a mammoth \$549 billion in total assets, \$4 billion in net income, \$360 billion in assets under management, and 118,000 employees. The current market capitalization would be \$70 billion. It would be the world's third-largest banking company, behind Bank of Tokyo-Mitsubishi Ltd. and Deutsche Bank.

There is no hard evidence that such a deal is in the works. Still, Merrill Chairman and Chief Executive David H. Komansky, 58, visited Chase Chairman and CEO Walter V. Shipley, 61, after Komansky assumed his post last December. And Street sources say both have examined the possibility of a merger, which just a couple of years ago would have seemed preposterous.

REVERSE TAKEOVER? To be sure, a friendly marriage of these two giants would have to overcome daunting financial, cultural, and managerial hurdles—not the least of which is who would be in charge. Chase would probably initiate such a move because it has much more to gain. Having wrung most of the cost savings out of its mergers with Chemical Bank and Manufacturers Hanover Corp., the new Chase is faced with slowing revenue growth. "It's something senior management is really concerned about," says one Chase banker. If Chase acquired Merrill's investment bank, it would end the bank's frustrating attempts to build an equity underwriting business.

Merrill has far less incentive. Some analysts believe that Merrill has a

stronger management and brand name than Chase. And in 1996, Merrill posted a 26.8% return on equity, vs. Chase's 18.4%. Merrill's price-earnings multiple is also higher than Chase's, 16.1 vs. 13.2. But in a world of 800-pound gorillas, Merrill might want to be even bigger.



MADE IN HEAVEN?

CHASE & MERRILL: A SPECULATIVE PRO FORMA*

MARKET CAPITALIZATION: \$70 BILLION (8/97)

CORPORATE ASSETS: \$549 BILLION

REVENUES: \$41 BILLION

NET INCOME: \$4 BILLION

EMPLOYEES: 118,000

ASSETS UNDER MANAGEMENT: \$360 BILLION

*1996 DATA

Says a Wall Streeter: "It gives them a stable base for the next decade."

Shipley would likely become the first chief executive of the new entity. But Merrill's aggressive, high-powered management team could eventually dominate in a so-called "reverse takeover."

A Merrill spokesman plays down the

possibility: "We believe we have the right strategy in place to make the most of the considerable growth opportunities ahead for Merrill Lynch and that we can, on our own, continue to do an excellent job of serving clients and building shareholder value." Says a Chase spokesman: "It is totally inappropriate to respond to hypothetical conjecture."

Even so, the merged firm could develop an awesome marketing machine to promote one-stop financial shopping for retail and corporate customers. And could enjoy major economies of scale by combining asset management, trading, and back-office operations. Few legal and regulatory obstacles stand in the way of a deal, experts say. Says Harvey P. Eisen, senior vice-president of investments for Travelers Group Inc.: "That's one of the few deals I think would be spectacular."

On the retail front, a marriage would give the combined entity much greater national presence. Chase operates branches only in the New York City area and Texas. Yet Merrill has 680 brokerage offices throughout the U.S. And the firm would be a powerhouse in mortgage lending, credit-card issuance, and gathering consumer deposits. James McCormick, president of First Manhattan Consulting Group Inc., sees a big payoff. If Chase could capture the banking business of even a "moderate" portion of Merrill's upscale customers, it could boost retail banking profits dramatically. "The top 10% of households are about ten times as profitable as an average bank customer," he says.

Chase probably wouldn't buy Merrill since the goodwill hit would be large. Any deal would likely be structured as a stock-for-stock transaction using "pooling of interest" accounting.

Most agree, though, that executing the merger would be extremely tough. Merrill's rough-and-tumble investment bankers would clash with Chase's more staid commercial bankers. Says bank analyst R. Harold Schroeder of Keefe, Bruyette & Woods Inc.: "How do you structure it without people running around thinking you can."

Moreover, experts say the combined entity might be forced to pare Merrill's real estate, insurance, and merchant banking activities to comply with Federal Reserve bank rules. Indeed, says Merrill, just talking to bank regulators might be like a cold shower. Which is another reason this potentially hot deal might have to simmer for some time.

By Phillip L. Zweig, with Linda Nathans Spiro and Debra Sparks
New York

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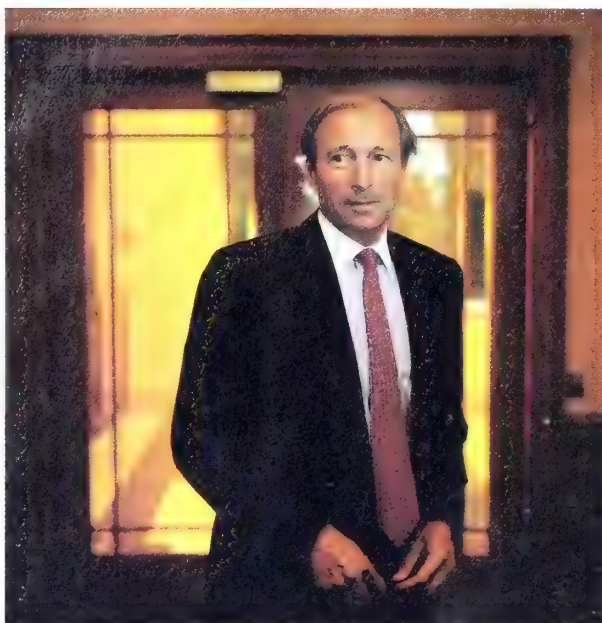
After getting itself in shape, Scudder takes on Kemper

Edmond D. Villani could hardly be more thrilled. The chief executive of Scudder, Stevens & Clark Inc., holding forth in his luxurious Park Avenue office, displays a chart showing Scudder's diversified U.S. equity mutual funds beating the competition at the 25 largest fund families for the 12 months ending on June 30. "It's a marked turnaround in performance," he gushes, referring to Scudder's mediocre long-term record. "We've got a lot of positive momentum."

Villani's going to need all the Big Mo he can muster for his next task—merging the newly rejuvenated Scudder with the struggling Zurich Kemper Investments Inc. He's also charged with turning the combined company, Scudder Kemper Investments Inc., into a global powerhouse. That's in the deal he struck in June with Zurich Kemper when Scudder's 200 partners decided to sell the 78-year-old firm for \$2 billion.

The merger gives Villani access to Zurich Kemper's vast network of U.S. stockbrokers. He can sell investments through Zurich's offices in 50 countries. "Few firms will be able to match that level of distribution without going to great expense," says Burton Greenwald, a Philadelphia fund-industry consultant.

Distribution helps, but only as long as you have funds investors want. So Scudder will have to keep up the strong performance that has earned 15 of 41 funds top ratings from Morningstar Inc., the mutual-fund data service. Funds with four- and five-star ratings capture some 80% of new money flowing to funds. At Zurich Kemper, only 10 of



BREAK A LEG: The merger will test Villani's mettle

116 funds merit either of those ratings.

Kemper Funds, as the firm was known before The Zurich Group bought it for \$2 billion from Kemper Corp. in 1995, has underperformed for years. The company was heavy on bond funds when investors turned to equity funds. And its equity funds have been lackluster, in part because of high management turnover. The flagship Kemper Growth Fund has run through four managers since early 1994.

Zurich Kemper also suffered a blow when star money manager David Dreman, whose firm it bought in 1995, left in June to set up shop independently. Although Dreman signed a five-year deal for Kemper to distribute his funds, he says that "the whole process of management is easier" with him

working independently of Kemper. Markus Rohrbasser, Zurich's chief financial officer, says Scudder will "materially strengthen the investment portfolio at Kemper." But he also emphasizes that unit is already improving, and notes that net sales turned positive this year for the first time since

1992. The loser in the merger could be Zurich. Kemper's chief executive, Stephen B. Tiers, says that beyond his future role has yet to be determined.

FRIEND OF BILL. So many details about the merged company. Villani says that beyond combining certain back-office operations, "it's hard for me to tell what will be optimal for [combining] these organizations." As starters, he will eliminate some no-load Scudder funds and sell them to load products through Zurich Kemper's brokerage network.

By the accounts of those who know him

Villani, 50, is up to the task. He's an ambitious and personable executive who has shaken up Scudder's formerly sluggish ways. After attending Georgetown University, where he was a classmate and friend of Bill Clinton (he's still an advisor and has jogged with the President), Villani earned a PhD in economics from the University of Pennsylvania in 1973 and joined Scudder as an economist the next year. He eventually took over the firm's money-market funds, and from 1991 to 1996 was part of a triumvirate that ran Scudder.

Villani, who became CEO in May, 1997, played a key role in pulling off Scudder's rebound. He added 17 new funds, including a broad line of equity funds, and began to distribute funds through fund supermarkets such as Schwab & Sonnet. Villani also went outside for executive talent, especially in marketing. Industry consultant Neil Bathon of Financial Research Corp. says Scudder's marketing is "one of the strongest in the industry."

Still, Villani will have to muster the talent he can—marketing, operations and especially portfolio management. Scudder Kemper is going to be worth the \$4 billion that its Swiss-based parent has spent on it.

By Geoffrey Smith in Boston

Scudder & Zurich Kemper: Vital Statistics

MORNINGSTAR INC. STRATEGIC INVESTMENT

	SCUDDER	ZURICH KEMPER
TOTAL ASSETS UNDER MANAGEMENT	\$120 BILLION	\$80 BILLION
MUTUAL FUND ASSETS	\$38 BILLION	\$31 BILLION
MUTUAL FUND MARKET SHARE 1991*	1.91%	2.96%
MUTUAL FUND MARKET SHARE 1997*	1.39%	1.14%
NO. OF 4 & 5 STAR FUNDS—1991**	9 of 26	7 of 27
NO. OF 4 & 5 STAR FUNDS—1997**	15 of 41	10 of 116

* Mutual-fund industry market share. Does not include pension assets or private accounts.

**Not including Scudder's AARP funds.



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BY GENE G. MARCIAL

WHY SGS-THOMSON IS IN THE CHIPS

When SGS-Thomson Microelectronics (STM)—France's answer to Intel—was highlighted in this column on Jan. 1, 1996, the stock was at 33, and fans were projecting 60 in 12 months. Well, SGS has streaked way past that: It closed at 90 on Aug. 5. After such a showing, is it time to bail out?



Not a chance, says Ray Hirsch of American Express Financial Advisors, which has accumulated nearly 700,000 shares at an average cost of 35 each. How much more oomph is Hirsch expecting from Big Board-listed SGS?

Based on the company's technology, Hirsch sees the stock hitting 120 in 12 to 18 months—thanks also to investors' recognition of SGS's lead in the "systems-on-a-chip" technology and the company's dominance in chips for smart cards, which are popular in Europe.

Systems-on-a-chip technology melds the functions typically embedded in separate chips—memory, logic processing, or analog-digital conversion—onto one chip. With these functions consolidated, the usual circuit board can be discarded.

Systems-on-a-chip, usable in set-top boxes, satellite disks, or digital video disks, is already on sale. It won't be a factor this year, says Hirsch, but will boost bottom-line growth in '98.

Hirsch says a similar potential exists for smart cards. These resemble credit cards but include a chip that can store more data than a magnetic stripe. Only 2% of the world's smart cards are in the U.S.; Europe has 90%. The global total is projected to grow from 650 million now to 4 billion by 2000.

"We control 35% of the smart-card chip market worldwide," says Jean-Philippe Dauvin, chief economist at SGS. Smart-card chips generate 4% of SGS's revenues. But revenues from smart cards could get much bigger as

the U.S. market grows, Dauvin says. SGS, ninth-largest in worldwide chip sales, is "among the best-managed chip-makers," says Mike Gumpert, a Lehman Brothers analyst. He expects SGS to earn \$3.30 a share this year, \$4.55 in 1998, and \$5.50 in 1999.

A SECOND LOOK AT STERLING VISION

For Sterling Vision (ISEE), the throng of short-sellers hasn't blurred the view of the smart-money investors who have been snapping up shares. They think recent moves by the operator of 350 optical stores in 27 states will send the shorts scrambling for cover.

So far, the shorts have had the upper hand, with Sterling's shares stuck in the 6-to-7 range, down from nearly 11 in January. But that could change: A far larger optical company is eyeballing Sterling for a buyout, says one money manager who has been buying. He figures Sterling is worth 20 in a takeover.

Lancer Partners, which holds 5.6%, has been buying more shares partly in anticipation of such a squeeze. This could occur even without a take-over, because management is determined to enhance shareholder value.

There is talk that Sterling Vision, a purveyor of eyeglasses and laser-based eye surgery, may authorize a share buyback and hire an investment bank to find ways of boosting the stock. Chairman Robert Cohen wouldn't comment on the rumors, but he acknowledges that moves are afoot to boost sales and earnings. One way, he says, is to step up links with health maintenance organizations.

Last month, Sterling signed a pact with Oxford Health Plans to provide discount services for Oxford's Healthy Bonus program. "Two other major HMOs may sign up," says Cohen. "We see managed care as the source of tremendous growth." One analyst predicts Sterling returning to profitability this year and expects \$1 a share in '98, based in part on two acquisitions being negotiated.

THE SHORTS HAD THEIR DAY



BLACK INK FROM THE MISSISSIPPI?

The waters haven't been kind to American Classic Voyages (AMCV). In the past three years, the river cruise line has drifted into the red. But its stock, which dipped to 9 from a high of 12% in February, has made a comeback: It closed above 11 on Aug. 5. What's up?

One big stakeholder who has been a steady buyer despite the losses is Chairman Sam Zell, a real estate mogul and financier. Equity-DQSB—group that includes Zell and American Classic directors Arthur Greenberg, Ann Lurie, and Sheli Rosenberg—hold 51% of the stock. The curious thing is that, on July 31, the board authorized repurchase of 1 million shares on the open market or in negotiated transactions. American Classic has 13.9 million shares outstanding.

Some pros believe Zell is preparing to take the company private in a leveraged buyout. "American Classic is an attractive target for larger cruise-line companies," says one money manager who has been snapping up shares. "In the past two weeks, more market makers have come into the stock, suggesting a surge of new interest," says one trader.

American Classic has three paddle wheel steamers that cruise the Mississippi. One of its ships, the Delta Queen, is a National Historic Landmark. Another ship, the Mississippi Queen, carries 416 passengers, and its newest vessel, the American Queen, has a capacity of 436 passengers. American Classic also owns the 582-foot Independence, which cruises the Hawaiian islands.

Analyst Phil Fisher of San Francisco's Genesis Merchant Group Securities figures American Classic will be in the black soon, earning 36¢ a share in 1997 and 77¢ in 1998. The buyback would add 6¢ to earnings, he says. American Classic CEO Philip Calian says the buyback supports "the good investment value in the stock that the market doesn't perceive."

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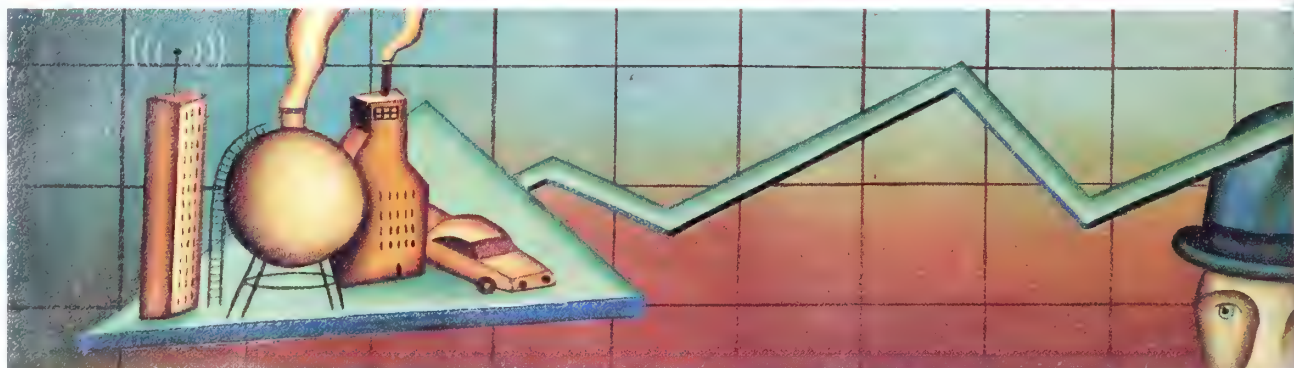


Transactions in the Age of the Consumer

Pamdy Mett
Senior Vice President
and CIO, Wal-Mart



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'THINGS STILL LOOK AWFULLY GOOD'

Growth may be slower—but at this pace, it's more likely to last

America's longest-lasting postwar economic boom is beginning to look more like a marathon than a sprint. The pace may have slowed, but the race appears far from over. In the second quarter of 1997, earnings for the 900 companies on BUSINESS WEEK'S Corporate Scoreboard rose 7% from a year earlier, to \$89.3 billion, on an 8% sales gain, to \$1.4 trillion. Eliminate a huge \$1.73 billion write-down-related

loss by drugmaker Eli Lilly & Co., and profits would have risen 10%.

Although second-quarter profit growth slowed for the third year in a row and margins, at 6.4%, are below the first quarter's record 6.7%, it's hard to find a pessimist. "Things still look awfully good," says David A. Wyss, research director at DRI/McGraw-Hill. "In the seventh year of an economic expansion, this is phenomenal."

Even the bad news doesn't seem too bad. The second-quarter slowdown was caused in part by the consumer, who pared big-ticket items, such as automobiles, and focused on paying the tax man. Growth in consumer spending fell just 0.8%, from 5.3% in the first quarter. But most economists think shoppers were just taking a breather. Consumer confidence remains high, and the unemployment rate fell to 4.8% in July—ty

Winners and Losers in Quarterly Profits

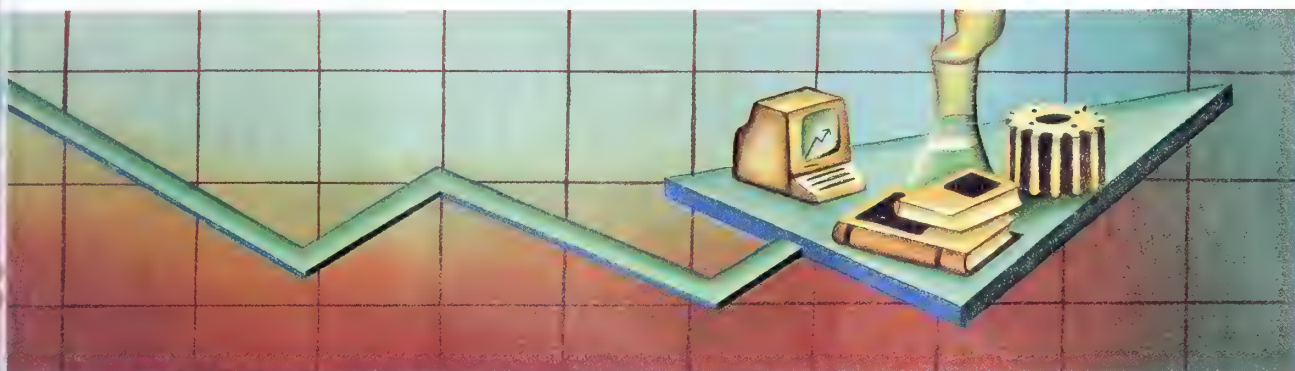
INDUSTRIES

COMPANIES

LEADERS		LAGGARDS		WHO MADE THE MOST		WHO LOST THE MOST	
PERCENTAGE CHANGE FROM 1996'S SECOND QUARTER		PERCENTAGE CHANGE FROM 1996'S SECOND QUARTER		MILLIONS OF DOLLARS		MILLIONS OF DOLLARS	
CONSTRUCTION/REAL ESTATE	322%	CONSTRUCTION/ENG.	LOSS	FORD MOTOR	\$2,530	ELI LILLY	-\$1,732
BUILDING MATERIALS	283	PAPER CONTAINERS	LOSS	GENERAL ELECTRIC	2,162	SBC COMMUNICATIONS	-787
STEEL	94	INDUSTRIAL DISTRIBUTION	-89%	GENERAL MOTORS	2,098	ENRON	-420
TRUCKING & SHIPPING	91	DRUG DISTRIBUTION	-64	EXXON	1,965	INTERNATIONAL PAPER	-419
PETROLEUM SERVICES	67	PAPER	-57	PHILIP MORRIS	1,836	CVS	-231
PUBLISHING	62	FOREST PRODUCTS	-45	INTEL	1,645	H.J. HEINZ*	-230
SEMICONDUCTORS	61	DRUGS & RESEARCH	-40	IBM	1,446	TENET HEALTHCARE*	-206
COMPUTERS & PERIPHERALS	51	TELEPHONE COMPANIES	-36	COCA-COLA	1,314	AMERICAN GENERAL	-124
APPLIANCES	47	MACHINE & HAND TOOLS	-36	MERCK	1,154	BAY NETWORKS*	-118
FOOD PROCESSING	46	EATING PLACES	-21	DUPONT	1,140	DARDEN RESTAURANTS*	-116
AUTO PARTS	42	POLLUTION CONTROL	-18	MICROSOFT*	1,057	STONE CONTAINER	-107
ELECTRONICS	37	BANKS-MIDWEST	-15	CITICORP	1,024	HFS	-106
INSURANCE	32	ELECTRIC UTILITIES	-12	AT&T	959	U S WEST MEDIA GROUP	-97
TRANSPORTATION SERVICES	32	MISCELLANEOUS SERVICES	-12	CHASE MANHATTAN	925	FERRO	-84
GLASS CONTAINERS	31	HEALTH-CARE SERVICES	-8	JOHNSON & JOHNSON	909	FLUOR	-70

DATA: STANDARD & POOR'S COMPUSTAT, A DIVISION OF THE MCGRAW-HILL COMPANIES

* FISCAL FOURTH QUARTER



for the lowest rate in 24 years. Likewise, growth in real gross domestic product slowed to a moderate 2% annual rate in the second quarter, down from a robust 4.9% rate in the first quarter, but economists seem more concerned about too much momentum than they are about a slowdown. And lately so—in July, there were signs the economy was picking up again. The National Association of Purchasing Management index that measures the outlook for inventories, jobs, and production hit 58.6%, from 55.7% in June.

EAT SHAPE. With the same already tried basics—a roaring stock market, healthy income growth, and strong productivity increases—the economy looks capable of overcoming anything, including a strengthening dollar and rising costs of imports (page 160). BUSINESS WEEK economists think the economy will rebound in the second half, with annualized real GDP growth above 3%. Bruce Venter, chief economist at Merrill Lynch & Co., expects a 13% boost in fits this year for the companies in Standard & Poor's 500-stock index. "The bottom line is that the economy is in better shape, and there is no obvious imbalance in it," he says.

Atop BUSINESS WEEK's list of second-quarter winners was Ford Motor Co., which made \$2.5 billion. That's an industry record, and a gain of 33% from \$1.9 billion it posted a year ago. Meanwhile, General Motors climbed 3%, to \$40.3 billion. How did Ford rev up earnings? Cutting \$1 billion in costs helped, as did Ford's hot new Expedition sport utility vehicle. Unlike last year, Ford didn't stall in the third quarter, says Chairman and Chief Executive Alexander J. Trotman. "I'm very confident we'll have a good second half," he says. Ford's rivals didn't fare as well. General Motors Corp. and Chrysler Corp. were both hurt by softening car sales, increased Japanese competition, and weak sales, which held auto makers' profits down to just 4% for the quarter. GM's profits were flat, at \$2.1 billion, while

Chrysler's earnings fell 53%, to \$483 million. Chrysler's labor problems are behind it now, but workers at nine of GM's plants still lack contracts.

Consumers may have been counting their pennies, but businesses spent with abandon—especially on technology. The software, hardware, and semiconductor industries all had powerful quarters. Demand for Office 97 and Windows helped push earnings at Microsoft Corp. up 89%, to \$1.06 billion, on a 41% sales increase, to \$3.18 billion. Dell Computer Corp. showed growth in both sales and earnings, which rose 58%, to \$2.6 billion, and 141%, to \$198 million, respectively.

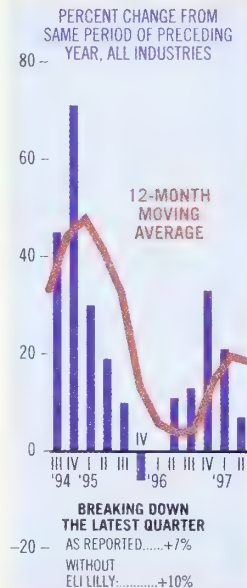
That red-hot growth already may be cooling, though. Microsoft said that Office 97 sales were slowing. And while Intel Corp.'s performance led semiconductor companies, with earnings up 58%, to \$1.65 billion, on a 29% sales gain, to

\$5.96 billion, it barely met expectations. Demand for its older Pentium chips is falling fast, and Intel is facing price pressure from Advanced Micro Devices Inc. and others. On July 25, Salomon Brothers Inc. analyst Erika Klauer lowered her 1997 Intel earnings estimates from \$7.65 billion to \$7 billion.

The good news was more widespread among insurers. A relative dearth of natural disasters and ongoing consolidation led to a banner quarter. Travelers Property Casualty Corp., 84% owned by Travelers Group Inc., saw earnings rebound, to \$276 million, from a \$220 million loss resulting from charges related to the 1996 purchase of a unit of Aetna Inc. Transamerica Corp., which sold off its consumer finance unit for a \$275 million profit in the quarter, saw earnings shoot up 266%, to \$388 million. And although brokerages faced what Michael A.

A Spotlight on Second-Quarter Profits

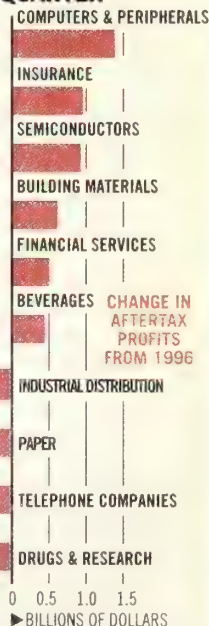
AFTERTAX PROFITS QUARTER BY QUARTER



DATA: STANDARD & POOR'S COMPUSTAT, A DIVISION OF THE MCGRAW-HILL COMPANIES

INDUSTRIES WITH THE BIGGEST DOLLAR CHANGE IN THE QUARTER

When earnings growth slows, a single company with a big swing in profits can skew the numbers. Take out Digital Equipment's \$124 million profit in the second quarter, up from a \$432 million loss a year ago, and profits for the computer industry would have increased 26% instead of 51%. Conversely, Eli Lilly's \$1.7 billion loss put the kibosh on the drug group. Without Lilly, earnings overall would have been up 10%, making this a good, though not spectacular, quarter. Profit margins dipped slightly, but remained strong, while the price-earnings ratio climbed nearer to record levels.

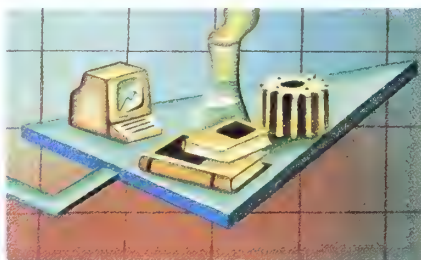


While consumers counted their pennies, companies spent with abandon—especially on technology

Flanagan of Financial Service Analytics called “killer comparisons” with last year’s second-quarter profit rise of 49%, they tacked on another 10% gain. Profits at Merrill Lynch & Co. rose 11%, to \$481 million, on sales up 29%, to \$8 billion.

Few of the airline companies flew as high. Despite strong demand and steady capacity, solid gains were hard to come by. Also hurting comparisons: a federal ticket tax that had lapsed for the first eight months of last year. Northwest Airlines Inc. posted the biggest decline with earnings of \$136.2 million in the quarter, down 33%, on sales up 1%, after jet overhauls raised maintenance costs.

A new-product bonanza helped most drugmakers post a strong quarter. But it wasn’t enough to offset Eli Lilly’s



\$2.4 billion write-off of its \$4.1 billion purchase of pharmacy benefits manager PCS Health Services in 1994. That cut the sector’s profits by 40%, even as sales climbed 9%. The telecommunications industry suffered too. Earnings tumbled 24% on a sales increase of 8%, owing partly to a \$1.6 billion charge from SBC Communications Inc. related to its

merger with Pacific Telesis Group. Long-distance companies AT&T, Sprint, and MCI Communications also took some heat, as smaller, nimbler rivals grabbed share. AT&T’s earnings fell 38%, to \$90 million, on sales of \$13.2 billion, up 2%.

“Telcos are having a hard time coping with deregulation,” says Rosanne M. Cahn, chief economist at Credit Suisse First Boston. “They haven’t figured out that they can still cut costs.”

They’re the exception. Most of Corporate America has settled into a rhythm of slow and steady profits. While this quarter’s numbers may not add up to an economic sprint, a slower-paced marathon lasts a whole lot longer.

By Jennifer Reingold in New York with bureau reports

IT’S NOT A SUPERDOLLAR—YET

The German mark is at an eight-year low against the dollar; the Japanese yen continues to falter, and some investors have begun to worry: How hard will the rallying dollar hurt U.S. companies?

Fears of a painful hit are probably unwarranted. True, the dollar has gained 20% against the currencies of major trading partners over the past two years. But its trading well below levels of the 1985 “superdollar.” Most economists expect it to stabilize near current levels—and figure that is manageable for U.S. companies. The economic backdrop is good, with growth healthy, inflation quiescent, and unemployment low. Over the past decade, American companies restructured their businesses and made huge technological investments, so they are better able to absorb the impact of a rising dollar.

FEWER FOREIGN BUCKS. “We’re in a wonderfully benign economic environment,” says Rudi Dornbusch, an economist at Massachusetts Institute of Technology. “The stronger dollar is something we can live with.”

Today the dollar buys 119 yen, up from 88 two years ago, but well below the superdollar level of 265 yen. With the greenback at current levels, imports will probably expand

13% this year and 9% the next, according to economic forecasters DRI/McGraw-Hill. That trend, combined with still weak demand for U.S. exports in some markets, could cause the trade deficit to increase to about \$250 billion next year, from \$190 billion this year.

U.S.-based producers that face stiff import competition, such as auto makers and capital goods manufacturers, will likely move to match lower foreign prices, and that could hold back profits. Detroit manufacturers, for instance, may have to depend more heavily on rebates to sell cars against the Japanese.

For multinationals operating overseas, a stronger dollar means that profits earned in a local currency translate back into fewer dollars than they did a year or two ago. But good overseas earnings growth—17.5% in 1995 and 15% in 1996, according to the Commerce Dept.—suggests multinationals made up the

difference with higher sales. The outlook is less certain: In the first quarter of 1997, the most recent period for which data are available, overseas earnings on an annualized basis dipped to \$140 billion from \$143 billion in the previous quarter.

But one quarter does not a trend make, and U.S. companies still can count on a number of factors in their favor. Richard D. Rippe, chief economist at Prudential Securities Inc., points to the companies’ effective hedging against currency fluctuations and efficiency gains in overseas plants. Rippe also notes that the countries where U.S. multinationals earn

the most are Britain and Canada, both of which have currencies that rallied against the dollar recently.

The strong greenback may turn out to be a “small negative” for U.S. multinationals, says Rippe. Unless the dollar rockets higher, corporate America should be able to withstand the earnings pressure.

By Karen Pennar in New York

THE RALLYING GREENBACK



Second Quarter 1997

CORPORATE SCOREBOARD

Summary

S: Includes all sales and operating revenues. For S, includes all operating revenues.

ITS: Net income before extraordinary items. For banks,

profits are net income after security gains or losses.

MARGINS: Net income from continuing operations before extraordinary items as percent of sales.

RETURN ON COMMON EQUITY: Ratio of net income available

for common stockholders (most recent 12 months) to latest available common equity, which includes common stock, capital surplus, and retained earnings.

PRICE-EARNINGS RATIO: Based on July 25, 1997, common-

stock price and corporate earnings from continuing operations before extraordinary items for most recent 12-month period.

EARNINGS PER SHARE: For most recent 12-month period. Includes all common-stock equivalents.

COMPANY	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY 12 MONTHS ENDING 6-30	PRICE- EARNINGS RATIO 7-25	12 MONTHS' EARNINGS PER SHARE
	2ND QUARTER 1997 \$ MIL	CHANGE FROM 1996 %	6 MONTHS 1997 \$ MIL	CHANGE FROM 1996 %	2ND QUARTER 1997 \$ MIL	CHANGE FROM 1996 %	6 MONTHS 1997 \$ MIL	CHANGE FROM 1996 %	2ND QUARTER 1997 %	2ND QUARTER 1996 %			
INDUSTRY COMPOSITE	1394389.0	8	2765616.0	9	89306.1	7	178635.6	13	6.4	6.5	16.9	23	2.30
AEROSPACE & DEFENSE													
INDUSTRY COMPOSITE	30555.2	15	57588.1	21	1414.3	0	2712.2	17	4.6	5.3	17.2	23	3.14
BAE SYSTEMS	9289.0	48	16607.0	57	334.0	-29	711.0	21	3.6	7.5	10.9	33	1.77
GENERAL DYNAMICS	1032.0	11	1973.0	8	80.0	19	151.0	14	7.8	7.2	16.6	18	4.59
BOEING	522.9	115	898.5	96	39.5	326	79.5	418	7.6	3.8	NM	20	1.41
LOCKHEED MARTIN	6898.0	-3	13572.0	11	308.0	3	598.0	5	4.5	4.2	21.5	14	7.03
RAYTHEON	3554.0	9	6778.0	6	195.0	4	376.0	-3	5.5	5.8	23.0	21	3.67
THORP GRUMMAN	2087.0	-3	4051.0	8	100.0	16	175.0	19	4.8	4.0	12.0	25	4.53
R (5)	249.3	22	462.6	20	10.8	162	15.7	262	4.3	2.0	5.3	34	0.69
BOEING	440.0	19	829.0	12	43.0	26	78.0	30	9.8	9.2	24.3	29	2.18
LOCKHEED TECHNOLOGIES	6483.0**	7	12417.0	9	304.0	17	528.0	25	4.7	4.3	22.6	22	3.87
AUTOMOTIVE													
INDUSTRY COMPOSITE	116081.6	1	225892.6	4	5898.6	4	10685.7	25	5.1	4.9	21.6	10	4.54
CARS & TRUCKS													
INDUSTRY COMPOSITE	102328.6	1	199066.0	3	5212.5	2	9579.4	26	5.1	5.0	23.8	8	5.32
CHRYSLER	13793.0	-10	29359.0	-1	483.0	-53	1512.0	-26	3.5	6.8	27.6	8	4.48
GM MOTOR	40265.0	3	76467.0	3	2530.0	33	3999.0	56	6.3	4.9	21.4	8	4.90
GENERAL MOTORS	45146.0	1	87387.0	4	2098.0	0	3894.0	34	4.6	4.7	25.7	8	7.47
FIAT	1536.0	5	2821.0	-2	30.0	15	45.0	-6	2.0	1.8	4.6	45	0.44
DAEWOO	1588.7**	54	3032.1	47	71.5	38	129.4	48	4.5	5.0	17.5	16	3.12
PARTS & EQUIPMENT													
INDUSTRY COMPOSITE	9973.5	8	19434.5	10	462.4	42	687.0	23	4.6	3.5	12.2	22	1.86
IN INDUSTRIES	632.5	8	1196.5	9	21.1	50	34.1	71	3.3	2.4	13.5	12	2.68
G-WARNER AUTOMOTIVE	449.7	18	893.2	22	29.6	36	54.4	60	6.6	5.7	9.7	21	2.63
MINI ENGINE	1396.0	6	2700.0	3	53.0	20	94.0	1	3.8	3.3	12.7	19	4.15
DAEWOO	2216.3	7	4467.5	9	93.8	3	186.4	10	4.2	4.4	20.3	13	3.13
ROIT DIESEL	557.4	13	1077.1	11	7.4	NM	13.8	NM	1.3	NM	7.7	25	1.04
ELIN (4)	931.2	10	1773.4	12	33.5	-23	57.1	-15	3.6	5.1	12.8	17	2.20
EL INDUSTRIES	264.5	-4	515.7	21	9.1	13	15.4	19	3.4	2.9	13.9	10	2.01
GENERAL-MOGUL	481.8	-10	967.4	-9	28.5	80	42.4	61	5.9	2.9	-87.3	NM	-5.80
CORP (1)	403.5	7	731.5	-2	84.1	496	95.2	NM	20.8	3.7	101.2	7	3.94
ES WHEELS INTERNATIONAL (11)	250.2	60	472.6	58	3.8	-38	-63.0	NM	1.5	3.9	NM	NM	-2.91
R	1839.3	14	3563.3	18	61.1	22	103.0	36	3.3	3.1	16.2	18	2.63
DINE MFG. (9)	256.9	3	500.3	2	18.2	11	34.5	14	7.1	6.6	16.6	14	2.16
INDARD PRODUCTS (6)	294.3	-3	576.0	-1	19.3	24	19.8	-13	6.6	5.1	10.8	16	1.64
TIRE & RUBBER													
INDUSTRY COMPOSITE	3779.5	1	7392.2	1	223.7	5	419.3	8	5.9	5.7	5.6	50	1.00
PER TIRE & RUBBER	464.0	16	843.5	8	31.5	25	56.7	17	6.8	6.3	14.9	17	1.43
DAYEAR TIRE & RUBBER	3315.5	0	6548.7	0	192.2	2	362.6	7	5.8	5.6	3.6	82	0.78

second quarter ended May 31. (2) Second quarter ended Apr. 30. (3) Third quarter and most recent six months ended June 30. (4) Third quarter and most recent six months ended May 31. (5) Third quarter and most recent six months ended Apr. 30. (6) Fourth quarter and most recent six months ended June 30. (7) Fourth quarter and most recent six months ended May 31. (8) Fourth quarter and most recent six months ended Apr. 30. (9) First quarter and most recent six months ended June 30. (10) First quarter and most recent six months ended May 31. (11) First quarter and most recent six months ended Apr. 30. *Sales include excise taxes. **Sales of other income. ***Sales include excise taxes and other income. †Revenues from major subsidiaries not included in consolidated sales. Earnings per share are for latest 12 months, not necessarily for end of most recent year; they include all common-stock equivalents but exclude extraordinary items. NA = not available. NM = not meaningful. DATA: STANDARD & POOR'S COMPUSTAT, A DIVISION OF THE MCGRAW-HILL COMPANIES

CORPORATE SCOREBOARD

COMPANY	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY 12 MONTHS ENDING 6-30	PRICE- EARNINGS RATIO 7-25	1 MON EARN PER SHA
	2ND QUARTER 1997 \$ MIL	CHANGE FROM 1996 %	6 MONTHS 1997 \$ MIL	CHANGE FROM 1996 %	2ND QUARTER 1997 \$ MIL	CHANGE FROM 1996 %	6 MONTHS 1997 \$ MIL	CHANGE FROM 1996 %	2ND QUARTER 1997 %	2ND QUARTER 1996 %			
3 BANKS													
INDUSTRY COMPOSITE	76977.1	8	151074.6	8	9735.4	2	19747.9	15	12.6	13.4	16.2	18	3.8
(A) BANKS - EAST													
GROUP COMPOSITE	34553.9	9	67760.6	8	4191.9	6	8333.7	25	12.1	12.5	17.9	16	4.6
BANK OF NEW YORK	1401.0	-20	2743.0	-12	269.0	-3	534.0	3	19.2	15.8	20.8	18	2.9
BANKBOSTON	1657.5**	5	3262.3	5	212.0	-1	418.8	14	12.8	13.5	15.3	18	4.3
BANKERS TRUST NEW YORK	2664.0	18	5177.0	13	181.0	20	350.0	21	6.8	6.7	13.8	13	7.9
CHASE MANHATTAN	7491.0	11	14715.0	8	925.0	8	1852.0	141	12.3	12.7	17.7	14	7.8
CITICORP	8589.0	7	16838.0	6	1024.0	8	2019.0	8	11.9	11.9	20.1	16	7.9
FLEET FINANCIAL GROUP	2140.0**	8	4104.0	8	328.0	18	639.0	18	15.3	14.1	18.7	15	4.3
MBNA	1130.1**	48	2178.0	47	138.4	34	262.4	34	12.3	13.5	30.7	29	1.8
MELLON BANK	1224.0**	6	2427.0	4	190.0	6	381.0	6	15.5	15.6	20.5	18	2.7
MORGAN (J. P.)	4325.0	10	8600.0	10	374.0	-15	798.0	-9	8.6	11.2	13.7	15	7.2
PNC BANK	1690.6	7	3357.8	6	259.1	4	525.4	8	15.3	15.7	18.9	14	3.1
REPUBLIC NEW YORK	925.0**	13	1798.9	13	110.5	7	220.7	9	11.9	12.6	14.6	15	7.4
STATE STREET	829.0**	25	1601.0	21	92.0	29	178.0	26	11.1	10.8	19.0	25	2.0
SUMMIT BANCORP.	487.7	9	958.7	7	88.9	18	155.4	112	18.2	16.8	14.8	18	3.2
(B) BANKS - MIDWEST													
GROUP COMPOSITE	16232.9	5	31858.6	4	1977.0	-15	4309.7	-3	12.2	15.0	17.4	18	3.1
BANC ONE	3190.3	11	6321.6	9	15.8	-96	397.7	-51	0.5	13.7	13.4	21	2.5
COMERICA	784.8	3	1541.4	-1	129.7	10	253.5	8	16.5	15.5	17.3	19	3.8
FIFTH THIRD BANCORP	475.0	9	936.3	11	96.1	15	190.6	17	20.2	19.1	18.1	27	2.3
FIRST BANK SYSTEM	911.8**	-11	1793.8	-13	178.3	-30	350.1	-19	19.6	24.8	21.9	18	4.8
FIRST CHICAGO NBD	2504.0	-2	4917.0	-5	378.0	5	758.0	8	15.1	14.1	17.9	15	4.6
FIRST OF AMERICA BANK	510.0**	0	1035.6	0	73.2	17	152.6	25	14.3	12.2	16.6	17	3.1
FIRSTAR	463.9**	4	914.8	2	72.7	4	144.5	35	15.7	15.7	18.7	17	1.9
HUNTINGTON BANCSHARES	498.7	13	969.7	10	72.5	11	139.0	9	14.5	14.7	17.4	17	1.7
KEYCORP	1583.0	6	3097.0	4	223.0	3	435.0	2	14.1	14.5	17.0	17	3.5
MERCANTILE BANCORPORATION	499.1	5	985.7	7	32.2	-59	107.2	13	6.4	16.5	13.8	21	3.3
NATIONAL CITY	1252.3**	5	2441.6	3	198.3	8	394.4	10	15.8	15.3	17.8	17	3.4
NORTHERN TRUST	555.0**	15	1064.3	11	75.4	19	147.1	18	13.6	13.2	18.7	22	2.4
NORWEST	2417.9**	9	4709.9	10	331.4	16	653.3	17	13.7	12.9	20.5	19	3.2
OLD KENT FINANCIAL	337.7**	18	642.8	14	52.8	41	93.8	22	15.6	13.1	17.5	17	3.6
STAR BANC	249.4	12	487.1	10	47.6	20	92.9	19	19.1	17.8	20.5	23	1.9
(C) BANKS - SOUTH & SOUTHEAST													
GROUP COMPOSITE	15317.6	15	30048.0	13	2238.3	16	4365.4	23	14.6	14.5	15.0	19	3.3
BARNETT BANKS	1038.7**	9	2000.4	4	157.0	13	302.7	5	15.1	14.7	NA	18	3.0
BB&T	531.7	13	1033.0	11	86.0	13	169.1	14	16.2	16.2	17.4	18	2.7
CRESTAR FINANCIAL	435.2	0	871.6	1	75.8	13	147.6	12	17.4	15.3	13.4	21	2.2
FIRST AMERICAN	246.5**	20	489.5	20	35.3	14	69.4	14	14.3	15.0	15.3	18	2.2
FIRST TENNESSEE NATIONAL	384.1	8	745.5	5	46.4	9	84.9	6	12.1	11.9	22.0	18	2.8
FIRST UNION	3314.0	11	6485.0	11	485.0	10	956.0	40	14.6	14.7	17.7	15	3.1
NATIONSBANK	5303.0	22	10486.0	19	762.0	26	1471.0	32	14.4	13.9	13.2	16	4.3
POPULAR	415.2	16	803.8	13	51.1	11	100.6	10	12.3	12.8	15.9	15	2.8
REGIONS FINANCIAL	467.9**	17	916.9	17	73.4	19	143.7	26	15.7	15.3	15.0	17	1.9
SOUTHRUST	622.2**	24	1194.9	23	75.4	19	146.3	21	12.1	12.6	15.0	16	2.8
SUNTRUST BANKS	1126.5**	13	2215.4	11	165.4	9	326.5	8	14.7	15.2	13.3	21	2.9
UNION PLANTERS	347.3**	-1	695.7	0	59.9	23	119.0	24	17.2	13.9	12.6	23	2.2
WACHOVIA	1085.3	10	2110.3	8	165.6	4	328.7	6	15.3	16.1	18.1	16	4.0
(D) BANKS - WEST & SOUTHWEST													
GROUP COMPOSITE	10872.8	3	21407.4	11	1328.2	0	2739.2	6	12.2	12.6	12.6	20	4.1
BANKAMERICA	5801.0	7	11426.0	6	799.0	11	1579.0	9	13.8	13.3	15.2	18	3.9
FIRST SECURITY	359.8**	14	698.7	14	49.0	14	97.0	22	13.6	13.6	17.5	16	1.6
PACIFIC CENTURY FINANCIAL	305.2	7	600.7	9	35.6	3	71.1	6	11.7	12.1	12.9	15	3.3
U. S. BANCORP	827.7	7	1610.7	6	125.6	-1	247.1	3	15.2	16.4	18.0	21	3.1
UNIONBANCAL	617.1	6	1218.3	4	91.0	117	178.0	46	14.8	7.2	12.3	15	5.1
WELLS FARGO	2962.0	-6	5853.0	24	228.0	-37	567.0	-10	7.7	11.6	7.3	27	9.9
4 CHEMICALS													
INDUSTRY COMPOSITE	39993.7	5	77879.3	4	3599.7	9	6669.2	5	9.0	8.6	22.3	19	2.6
AIR PRODUCTS & CHEMICALS (3)	1150.3	15	2303.4	15	116.0	18	222.0	-5	10.1	9.8	16.3	23	3.7
ARCO CHEMICAL	956.0	0	1985.0	2	35.0	-57	83.0	-56	3.7	8.4	12.5	18	2.5
CABOT (3)	398.6	-13	830.6	-12	28.7	-20	58.1	-26	7.2	7.8	21.4	13	2.1
CROMPTON & KNOWLES	494.1	5	968.0	4	31.8	30	58.4	28	6.4	5.2	NM	NM	-0.1
CYTEC INDUSTRIES	315.5	-1	622.0	0	27.8	9	54.7	14	8.8	8.0	33.4	18	2.2
DOW CHEMICAL	5366.0**	4	10358.0	2	572.0	5	1026.0	0	10.7	10.6	25.4	11	7.9
DUPONT	11402.0***	2	22613.0	3	1140.0	14	2160.0	15	10.0	9.0	35.4	19	3.4
EASTMAN CHEMICAL	1208.0	-3	2379.0	-5	90.0	-20	162.0	-28	7.5	9.0	18.3	14	4.0
ENGELHARD	896.7**	14	1780.9	14	44.2	10	81.8	13	4.9	5.1	18.8	19	1.1
ETHYL	269.3	-10	535.0	-1	21.9	9	42.5	9	8.1	6.7	21.9	11	0.8
FERRO	363.0	5	705.2	2	-83.9	NM	-68.8	NM	NM	4.2	-13.5	NM	-1.7
FULLER (H. B.) (1)	328.9	3	633.0	1	11.1	32	16.9	53	3.4	2.6	15.0	13	3.6

RPORATE SCOREBOARD

IPANY	SALES				PROFITS					MARGINS		RETURN ON COMMON EQUITY 12 MONTHS ENDING 6/30	PRICE- EARNINGS RATIO 7/25	12 MONTHS' EARNINGS PER SHARE
	2ND QUARTER 1997 \$ MIL	CHANGE FROM 1996 %	6 MONTHS 1997 \$ MIL	CHANGE FROM 1996 %	2ND QUARTER 1997 \$ MIL	CHANGE FROM 1996 %	6 MONTHS 1997 \$ MIL	CHANGE FROM 1996 %	2ND QUARTER 1997 %	2ND QUARTER 1996 %				
GIA GULF	333.0	7	634.0	14	6.1	-40	8.4	87	1.8	3.2	7.3	28	0.68	
RICH (B. F.)	258.2	12	497.4	13	20.6	7	32.6	-7	8.0	8.3	386.1	14	1.99	
T LAKES CHEMICAL	578.1	14	1127.5	12	52.4	110	73.3	59	9.1	4.9	11.6	18	2.46	
	549.9	-8	1043.4	-8	62.4	-20	115.3	-20	11.3	13.1	15.8	13	3.62	
IA (M. A.)	555.4	3	1083.0	5	17.1	9	32.3	11	3.1	2.9	12.3	19	1.38	
ULES	502.0	-8	997.0	-5	75.2	-15	183.2	11	15.0	16.2	37.3	16	3.33	
GLOBAL	1048.2	10	1713.0	2	88.3	33	127.4	119	8.4	7.0	13.8	16	2.16	
NATIONAL FLAVORS & FRAGRANCES	381.5	2	764.3	1	63.3	113	126.6	32	16.6	7.9	21.4	26	2.01	
IZOL	433.5	3	822.5	-1	46.9	23	85.8	-22	10.8	9.0	18.1	17	2.49	
DELL PETROCHEMICAL	789.0	29	1544.0	30	93.0	520	133.0	241	11.8	2.4	41.7	9	2.76	
ENNUIUM CHEMICALS	813.0	4	1607.0	6	82.0	NM	102.0	10	10.1	NM	10.7	11	1.96	
SANTO	2852.0	11	5426.0	11	324.0	-11	598.0	-4	11.4	14.2	8.8	86	0.58	
TON INTERNATIONAL (6)	634.7**	19	1661.7	9	53.5	150	162.8	26	8.4	4.0	12.1	23	1.48	
DUSTRIES	252.8	-4	492.3	-2	2.3	-81	-33.5	NM	0.9	4.5	NM	NM	-0.93	
	632.4	-10	1223.6	-12	38.6	-24	80.4	-21	6.1	7.2	28.1	8	5.10	
AIR	1178.0	8	2336.0	7	107.0	32	209.0	113	9.1	7.4	19.1	23	2.40	
I & HAAS	1089.0	3	2075.0	1	117.0	16	221.0	10	10.7	9.6	22.9	16	5.94	
ILMAN (A.) (4)	259.2	2	500.4	3	13.7	13	23.5	19	5.3	4.8	12.5	18	1.32	
TS (3)	299.0**	21	645.2	29	21.2	179	49.1	170	7.1	3.1	9.8	45	0.61	
LING CHEMICALS HOLDINGS (3)	239.2	10	479.0	17	-5.5	NM	-13.3	NM	NM	7.5	NM	NM	-1.96	
A INDUSTRIES	1221.9**	13	1655.6	12	89.8	26	93.7	4	7.4	6.6	20.0	7	1.84	
N CARBIDE	1666.0	7	3304.0	8	191.0	10	348.0	5	11.5	11.1	27.5	12	4.47	
MAN	279.2	-2	534.3	-9	5.3	-55	14.0	-40	1.9	4.1	2.7	38	0.55	

CONGLOMERATES

ISTRY COMPOSITE	44274.1	12	85102.2	11	3282.1	11	5890.1	9	7.4	7.5	20.6	28	2.14
GHENY TELEDYNE	957.1	-4	1915.0	-5	87.0	44	150.4	6	9.1	6.1	24.5	24	1.27
DSIGNAL	3578.0	7	6905.0	-3	305.0	12	564.0	13	8.5	8.1	25.9	24	3.85
TER INTERNATIONAL	682.6	12	1341.3	14	10.4	28	21.5	17	1.5	1.3	9.4	22	0.82
GROUP (11)	364.5	133	550.1	55	1.2	NM	-13.5	NM	0.3	NM	-12.5	NM	-7.89
RAL ELECTRIC	21997.0**	15	42154.0	17	2162.0	13	3839.0	12	9.8	10.0	25.3	31	2.34
CURT GENERAL (2)	880.0**	4	1648.7	7	3.1	-71	17.7	-34	0.4	1.2	18.1	19	2.51
OFFICE SOLUTIONS (3)	1316.3	24	2594.2	25	30.1	-31	44.7	-47	2.3	4.1	9.5	33	0.86
NDUSTRIES	2250.9	0	4417.5	-1	82.6	21	126.9	18	3.7	3.0	28.8	13	2.00
(5)	275.3	-1	509.3	-1	-22.2	NM	5.5	-92	NM	14.6	9.4	39	0.63
WAY	339.2	25	640.4	21	16.6	32	28.9	-37	4.9	4.6	12.3	21	2.68
MARK INTERNATIONAL	594.4	5	1140.0	4	28.3	NM	49.1	NM	4.8	NM	12.7	17	1.69
WELL INTERNATIONAL (3)	1929.0	2	3828.0	4	131.0	-10	286.0	7	6.8	7.7	10.0	27	2.36
IECO	1892.0	12	3521.0	9	104.0	-12	180.0	1	5.5	7.0	8.6	37	1.29
RON	2667.0**	12	5218.0	13	145.0	16	270.0	15	5.4	5.2	16.1	23	3.03
	2852.0	11	5512.0	8	135.0	16	254.0	16	4.7	4.5	9.9	34	1.72
II	280.2	-2	545.5	0	2.6	-53	-20.5	NM	0.9	1.9	-10.4	NM	-0.26
	614.9	8	1184.7	8	26.7	196	37.2	113	4.3	1.6	19.7	35	0.53
MAN	803.6	4	1477.7	3	33.7	-19	49.2	-15	4.2	5.4	21.2	20	1.25

CONSUMER PRODUCTS

JSTRY COMPOSITE	75374.3	5	146764.0	5	6761.6	21	12821.4	19	9.0	7.8	26.6	29	2.01
APAREL													
UP COMPOSITE	7073.9	12	14300.4	15	341.1	7	790.4	29	4.8	5.0	19.7	21	2.54
WN GROUP (11)	391.8**	10	750.8	7	1.5	193	2.9	-32	0.4	0.1	9.2	14	1.21
S APPAREL GROUP	263.0**	36	581.0	28	19.3	45	48.8	45	7.3	6.9	23.5	30	1.77
WOOD (8)	448.3	9	764.1	9	15.3	47	17.3	107	3.4	2.5	10.8	18	1.78
LAIBORNE	537.9	7	1134.5	7	28.9	28	71.1	21	5.4	4.5	16.4	21	2.35
(7)	2373.9	24	4797.6	37	155.8	0	392.9	35	6.6	8.1	25.2	23	2.68
WEST GROUP (11)	406.1	14	787.8	12	17.5	17	25.0	NM	4.3	4.2	22.7	17	2.35
LIPS-VAN HEUSEN (11)	285.9	4	666.8	1	-4.5	NM	3.4	NM	NM	NM	7.2	19	0.76
OK INTERNATIONAL	841.1	3	1771.1	3	20.3	3	60.5	-11	2.4	2.4	31.7	24	2.13
SELL	270.3	-7	528.4	-4	8.1	-50	19.4	-31	3.0	5.6	10.9	15	1.91
	1255.5	3	2518.3	6	78.9	13	149.1	19	6.3	5.7	16.3	17	5.00
APPLIANCES & HOME FURNISHINGS													
UP COMPOSITE	11039.1	3	23012.1	2	300.1	47	616.2	37	2.7	1.9	6.6	46	0.77
STRONG WORLD INDUSTRIES	577.4	3	1095.7	3	58.9	92	104.4	56	10.2	5.4	25.9	15	4.87
R BUY (10)	1606.6	-2	3954.1	-6	-2.6	NM	5.9	-71	NM	0.0	-0.3	NM	-0.02
UIT CITY STORES (10)	1856.9	15	4274.5	11	12.5	-26	80.7	-18	0.7	1.0	8.1	31	1.18
NITURE BRANDS INTERNATIONAL	444.2	6	894.0	6	16.5	42	33.6	49	3.7	2.8	23.4	20	1.02
IG-MEYERS (10)	566.3**	58	1044.5	50	13.8	11	24.3	59	2.4	3.5	6.4	22	0.80
-BOY (8)	287.5	8	532.0	8	15.6	11	25.4	17	5.4	5.3	12.6	15	2.50
ETT & PLATT	721.2	16	1394.4	15	52.0	95	100.4	56	7.2	4.3	19.3	22	2.02
TAG	814.5	8	1607.0	8	43.8	-1	82.3	36	5.4	5.9	25.0	18	1.62
BEAM	287.6	13	541.1	12	26.2	837	46.8	398	9.1	1.1	-34.9	NM	-1.94
JY	1146.0	-15	2437.7	-13	28.7	209	54.3	128	2.5	0.7	-6.0	NM	-1.12
J (2)	352.2	22	561.2	12	19.0	13	21.5	-15	5.4	5.8	14.3	14	2.62
RLPOOL	2117.0**	-7	4155.0	-4	65.0	25	111.0	23	3.1	2.3	9.3	20	2.36
TH ELECTRONICS	261.8**	-7	520.9	0	-49.3	NM	-74.5	NM	NM	NM	NM	NM	-2.78

CORPORATE SCOREBOARD

COMPANY	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY 12 MONTHS ENDING 6-30	PRICE- EARNINGS RATIO 7-25	MO. EARN. PER SH.
	2ND QUARTER 1997 \$ MIL	CHANGE FROM 1996 %	6 MONTHS 1997 \$ MIL	CHANGE FROM 1996 %	2ND QUARTER 1997 \$ MIL	CHANGE FROM 1996 %	6 MONTHS 1997 \$ MIL	CHANGE FROM 1996 %	2ND QUARTER 1997 %	2ND QUARTER 1996 %			
(C) BEVERAGES													
GROUP COMPOSITE	19877.4	4	36375.1	4	2563.0	21	4257.2	20	12.9	11.1	33.4	40	1.1
ANHEUSER-BUSCH	2994.3	1	5457.2	2	381.2	8	638.9	2	12.7	11.9	28.4	19	2.1
BROWN-FORMAN (8)	369.3	1	762.5	2	39.7	9	81.3	9	10.8	10.0	23.4	20	2.1
CANANDAIGUA WINE (10)	306.0	11	567.6	12	10.0	18	16.0	-14	3.3	3.1	8.0	26	1.1
COCA-COLA	5075.0	-4	9213.0	-3	1314.0	25	2301.0	31	25.9	19.9	61.2	43	1.1
COCA-COLA ENTERPRISES	2905.0	44	5046.0	40	111.0	88	78.0	18	3.8	2.9	8.2	92	0.1
COORS (ADOLPH)	520.8	3	919.8	5	51.0	114	59.1	184	9.8	4.7	11.6	14	2.1
PEPSICO	7707.0	0	14409.0	1	656.0	13	1083.0	11	8.5	7.6	19.0	47	0.1
(D) PERSONAL CARE													
GROUP COMPOSITE	17311.1	5	33768.1	5	1357.2	13	2835.2	15	7.8	7.3	28.1	36	2.1
ALBERTO-CULVER (3)	456.2	10	895.8	10	19.2	17	37.0	20	4.2	4.0	17.2	19	1.1
AVON PRODUCTS	1225.0	9	2312.6	8	95.2	11	136.5	11	7.8	7.6	156.7	30	2.1
CLOROX (6)	762.5	13	1411.7	15	74.4	13	140.0	12	9.8	9.8	24.1	28	4.1
COLGATE-PALMOLIVE	2300.9	6	4448.0	5	175.8	18	345.4	18	7.6	6.9	33.3	34	2.1
DIAL	349.3	-1	665.5	-6	20.4	6	38.7	0	5.8	5.5	19.3	54	0.1
ECOLAB	411.8	10	785.6	11	32.9	19	59.1	25	8.0	7.4	24.4	24	1.1
GILLETTE	2285.2	1	4465.2	3	318.9	15	602.6	15	14.0	12.2	21.7	55	1.1
PROCTER & GAMBLE (6)	8948.0	4	17719.0	3	611.0	10	1492.0	14	6.8	6.5	26.9	32	4.1
REVLON	572.2	10	1064.7	8	9.4	527	-16.1	NM	1.6	0.3	NM	72	0.1
(E) TOBACCO													
GROUP COMPOSITE	20072.8	3	39308.4	3	2200.2	24	4322.4	18	11.0	9.1	29.6	16	2.0
FORTUNE BRANDS	1131.7	4	2154.8	5	4.3	-92	39.3	-55	0.4	5.1	7.7	21	1.1
PHILIP MORRIS	14290.0	4	28383.0	3	1836.0	13	3609.0	13	12.8	11.8	46.6	16	1.1
RJR NABISCO HOLDINGS	4286.0	2	8065.0	0	243.0	NM	456.0	167	5.7	NM	8.9	12	2.0
UST	365.1*	4	705.6	4	116.9	-2	218.1	-3	32.0	34.0	152.9	12	2.0
7 CONTAINERS & PACKAGING													
INDUSTRY COMPOSITE	8901.3	4	16922.4	5	238.1	-26	313.2	-48	2.7	3.7	7.7	40	0.8
(A) GLASS, METAL & PLASTIC													
GROUP COMPOSITE	4512.4	6	8285.2	11	253.7	31	365.3	35	5.6	4.6	13.7	21	1.1
BALL	643.7	7	1123.5	6	20.8	56	27.8	38	3.2	2.2	3.3	50	0.6
CROWN CORK & SEAL	2286.6	-3	4223.9	8	132.0	27	171.0	26	5.8	4.4	9.9	22	2.3
OWENS-ILLINOIS	1224.5	27	2280.8	22	86.9	30	141.5	33	7.1	6.9	30.6	17	1.8
SILGAN HOLDINGS	357.6	9	657.0	8	14.0	47	25.0	159	3.9	2.9	NM	19	2.0
(B) PAPER													
GROUP COMPOSITE	4388.9	1	8637.2	-1	-15.6	NM	-52.2	NM	NM	2.9	1.1	NM	0.1
BEMIS	481.3	17	956.8	20	28.0	11	47.9	2	5.8	6.1	16.8	23	1.9
JEFFERSON SMURFIT	785.0	-7	1563.0	-11	-4.0	NM	-11.0	NM	NM	3.2	NM	80	0.2
ROCK-TENN (3)	300.3	39	575.7	33	6.2	-54	-1.0	NM	2.1	6.3	5.7	29	0.9
SONOCO PRODUCTS	714.2	4	1401.8	3	46.0	-2	87.3	-3	6.4	6.8	19.9	18	1.8
STONE CONTAINER	1200.2	-6	2381.1	-9	-107.4	NM	-204.1	NM	NM	NM	-64.1	NM	3.4
TEMPLE-INLAND	907.9	3	1758.8	0	15.6	-56	28.8	-65	1.7	4.0	4.0	46	1.4
8 DISCOUNT & FASHION RETAILING													
INDUSTRY COMPOSITE	110745.0	13	244919.7	11	2138.6	19	7009.8	41	1.9	1.8	13.3	27	1.3
AMES DEPARTMENT STORES (11)	432.6**	-1	1139.6	3	-5.9	NM	14.8	250	NM	NM	19.0	14	0.8
AUTOZONE (4)	637.9	22	1175.9	24	46.1	23	75.5	16	7.2	7.2	18.3	24	1.1
BARNES & NOBLE (11)	595.7	17	1478.2	20	-3.9	NM	58.1	NM	NM	NM	11.6	32	1.5
BJ'S WHOLESALE CLUB (11)	678.9	9	1547.9	12	7.1	31	32.9	23	1.0	0.9	19.6	NA	N
BORDERS GROUP (11)	463.6	15	1190.6	11	0.4	NM	66.7	NM	0.1	NM	12.1	34	0.7
BRADLEES (11)	269.5**	-21	722.4	-21	-32.0	NM	-91.1	NM	NM	NM	NM	NM	-17.2
BRYLANE (11)	328.8	118	567.1	79	9.6	104	15.7	12	2.9	3.1	NA	NA	N
CALDOR (11)	525.6	-8	1368.7	-9	-36.3	NM	-102.0	NM	NM	NM	NM	NM	-10.4
CARSON PIRIE SCOTT (11)	258.1**	9	633.0	5	2.6	-73	31.1	-6	1.0	4.1	9.1	17	1.9
COLE NATIONAL (11)	249.5	75	490.5	54	2.4	150	-32.5	NM	1.0	0.7	NM	NM	-2.1
CONSOLIDATED STORES (11)	594.9	85	1790.6	118	-7.3	NM	102.5	110	NM	1.8	14.6	34	1.1
CORPORATE EXPRESS (10)	913.3	40	1814.0	51	10.0	-17	17.2	NM	1.1	1.9	6.0	41	0.3
COSTCO (4)	4836.2**	12	10075.1	12	66.3	61	163.7	45	1.4	1.0	12.2	24	1.4
DAYTON HUDSON (11)	5889.0**	9	14056.0	5	126.0	207	341.0	27	2.1	0.8	13.9	24	2.4
DILLARD'S (11)	1562.6**	4	3542.8	2	58.3	3	169.3	98	3.7	3.8	8.9	18	2.1
DOLLAR GENERAL (11)	520.0	14	1195.2	18	19.3	28	70.8	32	3.7	3.3	22.6	41	1.0
FAMILY DOLLAR STORES (4)	498.4	16	1028.7	17	23.1	23	43.1	24	4.6	4.4	14.6	25	0.8
FEDERATED DEPARTMENT STORES (11)	3409.1**	3	8444.0	-1	24.1	NM	313.3	51	0.7	NM	7.0	26	1.5
FRED RHUT	396.2	3	746.2	0	9.9	362	12.5	NM	2.5	0.6	8.6	19	1.0
FOOT LOCKER	426.0	2	802.9	6	15.1	-32	20.1	-29	3.5	5.3	17.0	13	2.0
GAP (11)	1231.2	11	2899.1	10	84.3	3	255.5	8	6.8	7.3	28.1	26	1.6
HECHINGER (11)	508.0	-10	946.6	-11	-13.5	NM	-34.9	NM	NM	NM	-9.0	NM	-0.7
HILLS STORES (11)	353.5	-5	1012.2	-5	-9.8	NM	-12.7	NM	NM	NM	-12.0	NM	-2.5
KOHL'S (11)	5657.3	30	10615.8	31	258.8	33	510.0	34	4.6	4.5	16.1	34	1.1

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CORPORATE SCOREBOARD

COMPANY	SALES			PROFITS			MARGINS			RETURN ON COMMON EQUITY 12 MONTHS ENDING 6-30	PRICE-EARNINGS RATIO 7-25	MOMENTUM P. SH.
	2ND QUARTER 1997 \$ MIL	CHANGE FROM 1996 %	6 MONTHS 1997 \$ MIL	CHANGE FROM 1996 %	2ND QUARTER 1997 \$ MIL	CHANGE FROM 1996 %	6 MONTHS 1997 \$ MIL	CHANGE FROM 1996 %	2ND QUARTER 1997 %	2ND QUARTER 1996 %		
HOMEBASE (11)	1039.2	7	2217.9	8	10.8	14	36.3	3	1.0	1.0	12.1	21
INTIMATE BRANDS (11)	704.0	20	1864.9	19	32.9	30	190.6	21	4.7	4.3	66.1	21
KMART (11)	263.0	4	16947.0	0	14.0	NM	249.0	NM	0.2	NM	5.4	19
KOHL'S (11)	600.5	28	1447.5	23	15.3	11	67.3	20	2.6	2.9	19.4	45
LANDS' END (11)	244.7	16	668.0	9	11.3	156	48.7	61	4.6	2.1	25.2	16
LIMITED (11)	1829.8	2	4796.0	5	24.9	12	238.3	-3	1.4	1.6	22.5	13
LOWE'S (11)	2400.8	26	4442.2	23	70.4	50	126.0	48	2.9	2.5	13.8	20
MAY DEPARTMENT STORES (11)	2675.0**	7	6776.0	7	98.0	0	521.0	5	3.7	3.9	21.1	19
MERCANTILE STORES (11)	683.3**	4	1671.4	1	19.3	46	82.0	-10	2.8	2.0	8.2	19
MEYER (FRED) (11)	1193.9	15	2189.7	9	13.3	40	40.9	45	1.1	0.9	10.5	25
MICHAELS STORES (11)	321.3	6	815.0	7	3.2	16	11.4	134	1.0	0.9	-8.5	NM
NEILMAN MARCUS GROUP (5)	506.5**	7	1168.5	6	20.7	10	46.3	11	4.1	4.0	13.8	25
NORDSTROM (11)	981.7**	4	2329.6	5	32.3	18	75.1	-8	3.3	2.9	10.9	29
OFFICE DEPOT	1531.8	11	3304.3	10	30.5	8	69.3	12	2.0	2.0	11.4	19
OFFICEMAX (11)	888.6	22	1855.4	19	15.7	25	45.9	11	1.8	1.7	6.7	24
PAYLESS CASHWAYS (1)	661.2	3	1148.7	5	13.2	NM	-21.4	NM	NM	0.9	-19.7	NM
PAYLESS SHOESOURCE (11)	645.1	7	1168.0	1	32.4	34	47.5	NM	5.0	4.0	13.3	22
PENNEY (J. C.) (11)	6705.0	44	14862.0	32	139.0	2	233.0	-50	2.1	3.1	7.7	26
PEP BOYS-MANNY, MOE & JACK (11)	489.3	14	933.7	11	23.1	15	45.8	18	4.7	4.7	13.0	20
PETSMART (11)	412.7	25	870.0	31	-0.7	NM	6.8	-54	NM	0.1	5.3	68
PROFFITT'S (11)	541.6**	44	1269.6	54	10.5	67	26.0	NM	1.9	1.7	7.4	34
ROSS STORES (11)	442.8	19	952.7	16	23.8	70	55.7	59	5.4	3.8	26.0	18
SAKS HOLDINGS (11)	520.4**	12	1120.8	11	12.6	NM	59.3	138	2.4	NM	9.7	28
SEARS, ROEBUCK	9731.0	7	18493.0	8	117.0	-57	299.0	-30	1.2	3.0	22.1	22
SERVICE MERCHANDISE	877.4	2	1563.8	-1	-17.5	NM	-124.8	NM	NM	NM	-18.4	NM
SHOPKO STORES (10)	720.0	18	1352.7	22	7.2	26	31.6	18	1.0	0.9	9.9	20
SPIEGEL	696.2	4	1298.1	0	-13.5	NM	-44.7	NM	NM	NM	-7.4	NM
SPORTS AUTHORITY (11)	320.5	18	699.0	17	2.6	27	19.4	28	0.8	0.8	9.8	19
STAPLES (11)	1155.0	26	2319.0	23	8.4	-35	55.3	15	0.7	1.4	13.2	43
TALBOTS (11)	240.7**	2	543.8	2	16.5	-21	33.0	-3	6.8	8.8	13.5	13
TJX (11)	1560.2	6	3506.6	13	48.5	110	124.0	300	3.1	1.6	22.3	22
TOYS 'R' US (11)	1924.1	17	6591.6	5	29.4	57	412.3	269	1.5	1.1	10.7	22
U. S. OFFICE PRODUCTS (8)	790.0	61	1546.7	63	12.9	104	23.7	19	1.6	1.3	6.4	30
VALUE CITY DEPARTMENT STORES (5)	238.7	13	567.2	11	4.9	NM	8.1	-53	NM	0.4	6.0	16
VENTURE STORES (11)	314.4**	-10	789.3	-16	-15.5	NM	-62.7	NM	NM	0.5	-43.0	NM
WAL-MART STORES (11)	25409.0	12	56265.0	12	652.0	14	1747.0	15	2.6	2.5	18.5	28
WICKES	237.3	4	396.7	4	1.3	-29	-3.8	NM	0.6	0.8	4.4	48
WOOLWORTH (11)	1768.0	-3	4136.0	-3	1.0	NM	101.0	NM	0.1	NM	14.9	19
ZALE (5)	244.4	10	749.5	11	-1.4	NM	50.1	14	NM	NM	9.2	16
9 ELECTRICAL & ELECTRONICS												
INDUSTRY COMPOSITE	45704.3	12	88386.9	10	4329.4	44	8636.2	40	9.5	7.3	17.3	28
(A) ELECTRICAL PRODUCTS												
GROUP COMPOSITE	5457.1	6	10560.5	4	438.5	18	803.6	18	8.0	7.2	20.6	18
COOPER INDUSTRIES	1384.9	2	2703.8	2	105.5	19	183.2	22	7.6	6.5	16.7	16
EATON	1909.0	7	3698.0	5	126.0	22	227.0	15	6.6	5.8	17.3	18
GENERAL SIGNAL	539.6	5	1045.2	5	34.4	9	58.7	3	6.4	6.1	18.7	19
HUBBELL	352.9	7	677.6	7	41.4	16	77.7	15	11.7	10.9	18.8	21
NATIONAL SERVICE INDUSTRIES (4)	515.3	0	1014.5	2	29.4	6	49.8	6	5.7	5.4	15.0	21
RAYCHEM (6)	465.5	8	893.3	5	59.7	23	128.2	42	12.8	11.3	30.0	16
UCAR INTERNATIONAL	290.0	20	528.0	9	42.0	11	79.0	8	14.5	15.8	43.4	14
(B) ELECTRONICS												
GROUP COMPOSITE	18896.7	9	36077.3	8	1228.4	37	2113.2	11	6.5	5.2	11.5	27
HARRIS (6)	1046.5	3	1967.9	4	68.2	13	123.9	19	6.5	6.0	13.1	16
HUGHES ELECTRONICS	4265.6	6	8393.8	10	541.4	77	776.6	26	12.7	7.6	13.5	17
LITTON INDUSTRIES (5)	1095.6	9	2056.1	18	42.0	8	78.2	9	3.8	3.9	16.0	15
MOTOROLA	7521.0	10	14163.0	3	268.0	-18	593.0	-16	3.6	4.8	8.3	47
NEXTLEVEL SYSTEMS	450.4	4	858.4	5	0.4	NM	5.4	NM	0.1	NM	NA	NA
QUALCOMM (3)	520.3	122	1106.0	188	35.9	NM	52.7	NM	6.9	0.6	7.2	48
RAYTHEON	3324.8	6	6223.9	5	209.5	0	392.9	-1	6.3	6.7	16.1	17
TRACOR	312.7	17	610.1	23	10.5	31	20.8	33	3.4	3.0	18.7	17
VARIAN ASSOCIATES (3)	359.9	-14	698.1	-16	52.4	53	69.8	4	14.6	8.2	24.0	16
(C) INSTRUMENTS												
GROUP COMPOSITE	3704.9	7	6925.0	4	203.2	-3	387.6	2	5.5	6.0	16.7	29
BECKMAN INSTRUMENTS	270.6	2	502.5	3	20.8	9	36.4	11	7.7	7.2	20.3	18
HONEYWELL	1977.3	12	3663.0	8	98.4	18	174.0	17	5.0	4.7	19.2	23
KLA-TENCOR (6)	276.2	-9	528.5	-11	0.6	-99	37.6	-63	0.2	16.7	11.4	50
PERKIN-ELMER (6)	347.4	14	670.3	11	21.5	126	31.9	NM	6.2	3.1	30.6	32
TEKTRONIX (7)	543.9	11	1022.8	11	36.9	31	65.6	30	6.8	5.7	15.5	18
TERADYNE	289.5	-9	537.8	-20	25.0	40	42.2	41	8.6	5.6	7.4	59
(D) SEMICONDUCTORS & OTHER COMPONENTS												
GROUP COMPOSITE	17645.5	18	34824.2	15	2459.4	61	5331.8	66	13.9	10.2	21.5	29
ADAPTEC (9)	271.4	34	536.6	35	59.7	233	106.5	81	22.0	8.9	19.6	33
ADVANCED MICRO DEVICES	594.6	31	1146.6	15	10.0	NM	22.9	NM	1.7	NM	-1.8	NM
ALTEC	1468.0	8	2860.9	5	107.3	-7	208.6	-10	7.3	8.5	9.2	42



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COMPANY	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY 12 MONTHS ENDING 6-30	PRICE- EARNINGS RATIO 7-25	1 MON EARN PER SH
	2ND QUARTER 1997 \$ MIL	CHANGE FROM 1996 %	6 MONTHS 1997 \$ MIL	CHANGE FROM 1996 %	2ND QUARTER 1997 \$ MIL	CHANGE FROM 1996 %	6 MONTHS 1997 \$ MIL	CHANGE FROM 1996 %	2ND QUARTER 1997 %	2ND QUARTER 1996 %			
ANALOG DEVICES (2)	300.8	-1	592.9	2	42.1	-4	81.3	-3	14.0	14.5	17.8	31	1.0
AVX (9)	313.8	17	614.3	9	34.9	8	65.6	-5	11.1	12.1	16.9	24	1.4
INTEL	5960.0	29	12408.0	34	1645.0	58	3628.0	88	27.6	22.5	39.4	23	3.8
JABIL CIRCUIT (4)	247.6	13	469.8	3	14.6	132	25.6	103	5.9	2.9	25.3	45	1.0
LSI LOGIC	332.0	2	640.4	1	45.8	-2	84.2	-5	13.8	14.3	9.7	30	1.0
MEMC ELECTRONIC MATERIALS	245.8	-24	468.1	-24	3.8	-92	1.0	-99	1.5	14.3	2.2	75	0.3
MICRON TECHNOLOGY (4)	965.0	25	1841.2	4	96.9	67	239.6	-3	10.0	7.5	10.0	35	1.3
MOLEX (6)	416.1	18	803.1	15	47.5	21	90.7	20	11.4	11.1	13.5	31	1.3
NATIONAL SEMICONDUCTOR (7)	599.2	-2	1279.7	6	-14.5	NM	192.6	500	NM	1.5	1.6	NM	0.0
READ-RITE (3)	310.2	30	592.3	19	31.2	NM	54.7	NM	10.0	NM	-0.7	NM	-0.1
SCI SYSTEMS (6)	1540.0	14	2859.3	16	32.0	30	58.1	33	2.1	1.8	20.1	21	3.7
SOLETRON (4)	983.2	44	1841.9	38	41.5	50	79.1	43	4.2	4.1	16.6	31	2.5
TEXAS INSTRUMENTS	2560.0	7	4823.0	-5	224.0	446	326.0	88	8.8	1.7	2.4	NM	0.6
THOMAS & BETTS	537.8	8	1046.2	6	37.7	22	67.2	18	7.0	6.2	9.2	43	1.3
10 FOOD													
INDUSTRY COMPOSITE	87647.3	5	171170.6	4	2075.5	37	3174.7	-11	2.4	1.8	17.0	33	1.2
(A) FOOD DISTRIBUTION													
GROUP COMPOSITE	16631.2	3	32728.9	2	196.3	15	332.3	18	1.2	1.1	12.7	20	1.5
FLEMING	3550.7	-5	8302.7	-7	14.9	58	20.2	32	0.4	0.3	2.9	20	0.8
INTERNATIONAL MULTIFOODS (10)	667.2	7	1305.4	4	2.0	NM	-7.4	NM	0.3	NM	1.8	99	0.2
NASH FINCH	975.5**	33	1923.3	35	6.5	6	9.5	7	0.7	0.8	8.8	11	1.8
PERFORMANCE FOOD GROUP	292.8	52	561.3	54	3.8	20	6.0	25	1.3	1.6	11.7	24	1.0
PROSOURCE	970.8	-7	1987.9	-1	0.1	-92	0.3	NM	0.0	0.1	-9.3	NM	-0.8
RICHFOOD HOLDINGS (8)	1111.3	11	1918.6	9	21.3	38	36.3	89	1.9	1.5	25.7	19	1.3
SMART & FINAL	334.9	9	641.9	9	6.8	9	11.8	13	2.0	2.0	12.8	20	1.1
SUPERVALU (10)	5033.3	1	8922.9	1	49.8	8	102.7	8	1.0	0.9	13.7	15	2.6
SYSCO (6)	3694.7	4	7165.0	5	91.1	9	152.7	9	2.5	2.4	21.0	22	1.7

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COMPANY	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY 12 MONTHS ENDING 6-30	PRICE-EARNINGS RATIO 7-25	12 MONTHS' EARNINGS PER SHARE
	2ND QUARTER 1997 \$ MIL.	CHANGE FROM 1996 %	6 MONTHS 1997 \$ MIL.	CHANGE FROM 1996 %	2ND QUARTER 1997 \$ MIL.	CHANGE FROM 1996 %	6 MONTHS 1997 \$ MIL.	CHANGE FROM 1996 %	2ND QUARTER 1997 %	2ND QUARTER 1996 %			
FOOD PROCESSING													
P COMPOSITE	34605.1	3	67226.4	3	1283.8	46	1589.2	-24	3.7	2.6	15.3	39	1.24
BELL SOUP (5)	1870.0	2	4187.0	3	157.0	8	433.0	8	8.4	7.9	45.2	35	1.46
ITA BRANDS INTERNATIONAL	646.2	-9	1277.6	-5	41.1	-5	84.4	25	6.4	6.0	-5.2	NM	-0.69
IRA (7)	5795.3	1	11430.3	-1	186.5	NM	331.6	NM	3.2	NM	25.4	26	2.68
INTERNATIONAL	2104.5	-3	4253.9	0	-4.1	NM	113.3	-54	NM	6.5	20.1	35	2.82
FOODS (7)	787.6	7	1532.6	5	29.1	NM	49.7	NM	3.7	NM	15.3	22	2.16
FOOD	1107.8	6	2072.8	12	70.4	11	112.5	20	6.4	6.1	16.9	23	1.79
R'S GRAND ICE CREAM	272.0	29	472.4	25	6.2	23	6.1	-8	2.3	2.4	1.4	NM	0.10
GRAINS (9)	377.4	2	765.0	-15	6.9	886	8.8	NM	1.8	0.2	3.8	33	1.12
RS INDUSTRIES (6)	427.8	6	729.2	7	17.9	94	30.1	102	4.2	2.3	18.3	24	0.72
AL MILLS (7)	1444.0	4	2733.6	2	68.2	-12	191.0	-1	4.7	5.6	90.1	24	2.82
(H. J.) (8)	2446.7	-4	4754.2	1	-229.6	NM	-55.2	NM	NM	6.7	11.2	57	0.81
KEY FOODS	905.7	14	1908.2	10	50.6	24	119.5	19	5.6	5.1	24.6	29	1.90
EL FOODS (2)	798.5	7	1608.8	9	25.7	5	46.7	3	3.2	3.3	10.4	27	1.06
ON FOODS (3)	435.4	29	840.6	26	-14.9	NM	-8.3	NM	NM	1.0	3.0	50	0.32
	3448.3	6	6582.9	4	33.9	-61	66.2	-53	1.0	2.7	10.4	18	1.31
STATE BAKERIES (7)	755.2	1	1700.4	2	29.6	250	52.3	313	3.9	1.1	18.9	24	2.55
RMICK (1)	413.7	5	821.1	4	14.8	58	30.0	56	3.6	2.4	14.2	36	0.71
EL FOODS	237.9	57	433.3	47	8.4	155	12.3	88	3.5	2.2	1.4	NM	0.11
CO HOLDINGS	2191.0	1	4096.0	-2	103.0	NM	167.0	NM	4.7	NM	8.5	31	1.29
IM'S PRIDE (3)	335.2	14	638.6	13	7.3	624	12.2	NM	2.2	0.3	11.5	18	0.66
ER HI-BRED INTERNATIONAL (4)	1288.0	10	1552.0	7	332.0	10	330.0	8	25.8	25.9	20.5	25	3.04
ER OATS	1395.5	-6	2597.2	4	75.8	17	-1034.0	NM	5.4	4.4	NM	NM	-6.48
ON PURINA (3)	1531.8	4	3051.3	5	100.7	19	177.4	24	6.6	5.7	48.8	23	3.84
ANAH FOODS & INDUSTRIES (3)	303.5	6	580.0	8	11.4	141	20.2	654	3.8	1.6	15.0	12	1.15
FIELD FOODS (8)	927.5	6	2008.5	29	19.4	179	35.2	98	2.1	0.8	14.2	20	2.34
BUCKS (3)	242.2	37	457.1	38	14.6	55	24.3	22	6.0	5.3	10.6	59	0.64
N FOODS (3)	1591.2	-2	3165.5	-2	45.2	210	93.4	222	2.8	0.9	9.4	27	0.70
LEY (WM.) JR.	525.3**	9	976.4	7	76.6	34	139.5	22	14.6	11.8	27.7	34	2.20



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PROFITS

MARGINS

RETURN ON
COMMON
EQUITY
12 MONTHS
ENDING
6-30

PRICE-
EARNINGS
RATIO
7-25

(C) FOOD RETAILING

GROUP COMPOSITE	36411.1	9	71215.3	6	595.5	28	1253.2	6	1.6	1.4	23.6	24	1.8
ALBERTSON'S (11)	3607.5	8	7183.4	8	109.3	-3	263.5	-1	3.0	3.4	21.4	19	1.0
AMERICAN STORES (11)	4747.6	4	9657.3	0	34.2	-47	98.3	47	0.7	1.4	12.3	28	0.0
BRUNO'S (11)	685.3	-6	1437.6	NA	-5.1	NM	0.9	NA	NM	0.6	NM	NM	-2.0
CASEY'S GENERAL STORES (8)	263.7***	11	535.8	17	3.7	15	9.2	-8	1.4	1.4	11.9	22	1.0
DOMINICK'S SUPERMARKETS (2)	583.5	5	1186.4	4	3.9	434	9.1	549	0.7	0.1	1.2	NM	-0.0
EAGLE FOOD CENTERS (11)	239.9	-3	500.7	-6	1.8	74	2.3	NM	0.7	0.4	14.1	17	0.0
FOOD LION	2324.7	12	4601.5	12	49.7	2	95.3	7	2.1	2.3	16.6	16	0.0
GENERAL NUTRITION (11)	273.1	19	589.4	19	23.9	18	41.6	-4	8.7	8.8	3.2	NM	0.0
GIANT FOOD (10)	928.9	4	2142.9	1	14.9	-42	32.6	-54	1.6	2.9	8.5	27	1.0
GREAT ATLANTIC & PACIFIC TEA (10)	3104.6	0	5452.3	1	22.8	4	45.9	-3	0.7	0.7	8.1	14	1.0
HANNAFORD BROTHERS	775.7	6	1535.6	8	19.9	2	35.5	4	2.6	2.7	13.2	19	1.0
KROGER	6231.8	7	12371.2	6	108.1	38	200.4	29	1.7	1.3	NM	20	1.0
MARSH SUPERMARKETS (9)	343.9	2	672.6	3	2.9	NM	5.0	NM	0.8	NM	8.5	12	1.0
PENN TRAFFIC (11)	759.4**	-8	1574.3	-11	-22.8	NM	-29.2	NM	NM	NM	NM	NM	-5.0
QUALITY FOOD CENTERS	501.1	172	734.3	103	9.8	58	16.2	49	1.9	3.3	9.9	23	1.0
RUDDICK (3)	579.7	9	1143.7	8	13.1	-4	24.3	5	2.3	2.6	12.7	15	1.0
SAFEWAY	5249.2	33	9327.0	19	134.1	26	256.6	26	2.6	2.7	38.9	25	2.0
SMITH'S FOOD & DRUG CENTERS	780.2	13	1612.1	17	9.0	NM	15.8	NM	1.1	NM	NM	34	1.0
SUPERMARKETS GENERAL HOLDINGS (11)	922.4	1	1877.8	-6	-9.1	NM	-17.3	NM	NM	NM	NM	NA	0.0
WEIS MARKETS	446.9	3	903.7	4	19.2	-1	37.4	-4	4.3	4.5	9.4	17	1.0
WINN-DIXIE STORES (6)	3061.8	2	6175.8	2	52.4	-29	109.7	-20	1.7	2.5	15.6	28	1.0

11 FUEL

INDUSTRY COMPOSITE	121580.9	-1	246686.6	3	7665.6	8	15757.3	14	6.3	5.8	17.4	18	3.0
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(A) COAL, OIL & GAS

GROUP COMPOSITE	113866.3	-3	232035.5	2	6980.3	5	14520.5	11	6.1	5.7	17.6	17	3.0
AMERADA HESS	1878.8**	-26	4294.9	-10	41.7	-89	46.2	-90	2.2	14.8	8.0	20	2.0
AMOCO	8626.0**	-2	17619.0	4	622.0	4	1296.0	-2	7.2	6.8	17.1	16	5.0
APACHE	258.8**	16	580.7	35	25.7	5	78.6	96	9.9	10.9	10.2	20	1.0
ASHLAND (3)	3215.0	1	6214.0	3	119.0	57	126.0	70	3.7	2.4	9.2	19	2.0
ATLANTIC RICHFIELD	4587.0	1	9631.0	11	508.0	17	991.0	23	11.1	9.5	22.9	12	5.0
BURLINGTON RESOURCES	282.0	-5	666.0	21	79.0	65	189.0	120	28.0	16.2	15.0	16	2.0
CHEVRON	8500.0	-8	17980.0	-1	823.0	-6	1654.0	11	9.7	9.4	16.8	18	4.0
COASTAL	2079.6	-29	5285.4	-12	79.3	20	180.5	21	3.8	2.2	17.0	11	4.0
EXXON	29136.0**	2	59177.0	5	1965.0	25	4140.0	20	6.7	5.5	18.6	19	3.0
FINA	1034.6	-1	2148.6	7	40.0	5	79.2	4	3.9	3.6	12.4	13	5.0
KERR-McGEE	411.7	-12	879.7	-5	41.6	-18	111.8	13	10.1	10.8	16.6	13	4.0
MAPCO	854.3**	9	1785.5	17	10.7	-40	83.4	28	1.3	2.3	23.9	12	2.0
MOBIL	16749.0**	-14	32935.0	-14	850.0	9	1676.0	10	5.1	4.0	16.3	19	3.0
MURPHY OIL	507.7**	2	1016.0	11	27.6	11	58.2	29	5.4	5.0	13.5	17	3.0
OCCIDENTAL PETROLEUM	2717.0	11	5478.0	10	158.0	-13	337.0	-2	5.8	7.4	15.4	13	1.0
ORIX ENERGY	274.0**	8	609.0	22	23.0	-18	89.0	48	8.4	11.1	548.6	13	1.0
PENNZOIL	648.4**	2	1297.4	6	23.9	-3	81.4	102	3.7	3.9	16.7	21	3.0
PHILLIPS PETROLEUM	3709.0	-6	7653.0	2	307.0	39	534.0	-42	8.3	5.6	21.0	13	3.0
QUAKER STATE	342.8	14	660.7	14	8.8	23	15.7	22	2.6	2.4	5.4	33	0.0
SUN	2593.0**	-11	5337.0	-1	105.0	NM	123.0	NM	4.1	NM	-23.1	NM	2.0
TEXACO	11496.0**	2	23525.0	9	571.0	-17	1551.0	44	5.0	6.1	22.8	12	9.0
TOSCO	3196.4	32	5606.7	26	67.1	35	70.7	-4	2.1	2.0	9.8	29	1.0
TRANSMONTAIGNE OIL (8)	355.2	92	695.8	139	3.3	9	4.7	113	0.9	1.6	12.5	46	0.0
ULTRAMAR DIAMOND SHAMROCK	2414.4*	-6	4964.6	1	46.3	-2	73.9	7	1.9	1.8	-2.8	NM	-0.0
UNION PACIFIC RESOURCES GROUP	444.6	4	976.3	19	74.4	6	191.6	48	16.7	16.5	22.6	16	1.0
UNOCAL	1654.0**	18	3110.0	19	156.0	-17	344.0	8	9.4	13.4	20.4	23	1.0
USX-MARATHON GROUP	3775.0*	-7	7857.0	2	118.0	-5	226.0	-34	3.1	3.0	16.4	15	1.0
VALERO ENERGY	1362.6**	102	2184.4	75	27.6	52	47.4	125	2.0	2.7	5.9	22	1.0
VASTAR RESOURCES	763.5	14	1868.0	31	58.3	9	121.2	11	7.6	8.0	66.4	15	2.0

(B) PETROLEUM SERVICES

GROUP COMPOSITE	7714.6	26	14651.1	23	685.3	67	1236.8	68	8.9	6.7	16.3	27	2.1
BAKER HUGHES (3)	897.3	17	1730.5	15	82.0	75	140.0	58	9.1	6.1	14.0	24	1.0
BJ SERVICES (3)	368.6	67	712.3	69	28.1	210	48.3	258	7.6	4.1	9.7	30	2.0
COOPER CAMERON	441.4**	41	817.4	38	34.1	166	53.5	161	7.7	4.1	19.0	30	1.0
HALLIBURTON	2231.1**	22	4128.6	17	101.9	42	184.9	58	4.6	3.9	16.6	16	2.0
NABORS INDUSTRIES (3)	267.9	48	506.6	47	31.1	67	52.6	48	11.6	10.3	16.1	32	0.0
SCHLUMBERGER	2601.7	21	5003.7	20	306.5	56	566.4	54	11.8	9.1	17.5	35	2.0
SMITH INTERNATIONAL	383.2	42	740.6	45	23.9	60	45.0	61	6.2	5.5	21.0	34	2.0
TIDEWATER (9)	256.6	46	477.4	42	50.8	108	96.3	164	19.8	13.9	21.2	17	2.0
WEATHERFORD ENTERRA	266.8	14	533.9	18	26.8	80	49.7	75	10.0	6.4	10.7	25	1.0

CORPORATE SCOREBOARD

COMPANY	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY 12 MONTHS ENDING 6-30	PRICE-EARNINGS RATIO 7-25	12 MONTHS' EARNINGS PER SHARE
	2ND QUARTER 1997 \$ MIL	CHANGE FROM 1996 %	6 MONTHS 1997 \$ MIL	CHANGE FROM 1996 %	2ND QUARTER 1997 \$ MIL	CHANGE FROM 1996 %	6 MONTHS 1997 \$ MIL	CHANGE FROM 1996 %	2ND QUARTER 1997 %	2ND QUARTER 1996 %			
HEALTH CARE													
INDUSTRY COMPOSITE	80426.4	16	159102.0	15	4598.6	-25	11859.8	-8	5.7	8.8	21.0	34	1.91
DRUG DISTRIBUTION													
INDUSTRY COMPOSITE	24114.3	33	47734.5	32	102.4	-64	533.0	-21	0.4	1.6	9.9	39	1.37
AMGEN SOURCE HEALTH (3)	2064.2	45	3849.6	38	6.3	-39	19.5	-5	0.3	0.7	NM	26	1.84
AMGEN DRUGS (5)	238.4	15	488.7	16	7.5	24	18.3	24	3.2	2.9	15.0	30	0.82
AMGEN BRUNSWIG (3)	2927.9**	17	5818.3	18	22.2	16	42.7	8	0.8	0.8	13.0	18	1.56
AMGEN WESTERN INDUSTRIES	1811.0	49	3445.7	43	5.6	37	11.1	28	0.3	0.3	8.9	14	1.66
AMGEN HEALTH (6)	2790.7	15	5616.2	18	61.9	462	98.1	76	2.2	0.5	14.4	38	1.66
AMGEN DRUG STORES (11)	3160.6	19	6321.5	21	-230.8	NM	-148.1	NM	NM	4.3	-6.0	NM	0.13
AMGEN	710.9	7	1525.5	9	14.1	0	35.8	39	2.0	2.1	10.5	18	1.51
AMGEN (9)	4342.7**	63	8341.3	59	39.2	NM	76.7	433	0.9	NM	5.1	62	1.36
AMGEN (10)	2664.6	90	5321.8	88	68.2	109	123.4	38	2.6	2.3	7.7	28	1.90
AMGEN (4)	3403.3	14	7005.9	14	108.1	18	255.5	17	3.2	3.1	18.5	34	1.69
DRUGS & RESEARCH													
INDUSTRY COMPOSITE	26247.1	9	51647.1	8	2185.2	-40	6680.4	-11	8.3	15.3	26.1	35	2.18
AMGEN	284.5	-2	540.7	-1	21.4	NM	39.2	65	7.5	0.2	12.3	23	1.41
AMGEN HOME PRODUCTS	3499.8	0	7102.8	0	459.1	17	1035.8	18	13.1	11.2	28.1	26	3.18
AMGEN	620.5	9	1196.0	11	200.5	12	380.8	18	32.3	31.3	32.5	23	2.65
AMGEN-MYERS SQUIBB	4064.0	10	8109.0	10	738.0	13	1548.0	12	18.2	17.7	44.6	27	3.02
AMGEN (ELI)	305.0	4	610.1	6	15.7	3	31.1	11	5.2	5.2	7.2	60	0.34
AMGEN (K)	1988.7	17	3941.7	13	-1732.1	NM	-1299.5	NM	NM	20.4	-7.8	NM	-0.92
AMGEN (R)	5909.2	20	11477.1	22	1154.4	19	2174.7	18	19.5	19.8	33.9	29	3.50
AMGEN & UPJOHN	2913.0	9	5914.0	11	457.0	16	1059.0	16	15.7	14.8	29.0	37	1.60
AMGEN-POULENC RORER	1738.0	-4	3400.0	-5	178.0	116	372.0	181	10.2	4.6	12.7	24	1.53
AMGEN-PLOUGH	1238.0	-8	2323.8	-11	88.7	-13	155.5	-17	7.2	7.6	17.0	32	2.91
AMGEN-LAMBERT	1719.8	16	3287.9	15	373.1	18	748.4	16	21.7	21.5	57.4	28	1.80
AMGEN	1966.7	10	3744.1	3	231.4	8	435.5	-6	11.8	11.9	29.7	51	2.79
HEALTH-CARE SERVICES													
INDUSTRY COMPOSITE	15392.5	12	30620.1	13	412.4	-8	1060.0	-10	2.7	3.3	6.7	30	0.97
AMGEN HEALTHCARE GROUP	295.7	-4	609.6	1	-69.9	NM	-50.6	NM	NM	7.1	-16.4	NM	-1.17
AMGEN ENTERPRISES	820.7**	2	1640.9	2	21.0	23	39.4	28	2.6	2.1	6.9	25	0.62
AMGEN/HCA HEALTHCARE	5187.0	5	10515.0	6	412.0	13	891.0	14	7.9	7.4	17.9	15	2.39
AMGEN-TRY	301.1	17	600.4	21	6.6	NM	5.7	NM	2.2	NM	-46.4	NM	-1.40
AMGEN SCRIPTS	300.5	63	562.5	59	8.1	27	15.8	32	2.7	3.5	16.7	25	1.81
AMGEN MEDICAL MANAGEMENT	244.6	92	475.6	101	8.5	NM	-13.9	NM	3.5	NM	-68.8	NM	-2.83
AMGEN-SOUTH	722.3	15	1414.6	14	81.3	31	145.9	43	11.3	9.9	16.4	34	0.79
AMGEN-ANA	1836.0**	14	3668.0	15	42.0	NM	81.0	NM	2.3	NM	10.2	29	0.82
AMGEN-RATED HEALTH SERVICES	457.9**	36	919.0	38	9.2	-40	28.3	-3	2.0	4.5	8.2	18	1.82
AMGEN-RATORY CORP. OF AMERICA HOLDINGS	389.6	-5	781.1	-4	4.1	NM	6.5	NM	1.1	NM	-53.7	NM	-1.14
AMGEN-CENTERS OF AMERICA (3)	288.4	3	573.8	3	13.7	7	25.9	3	4.8	4.6	11.8	17	2.20
AMGEN-OR	267.4	51	518.0	53	13.7	63	26.0	61	5.1	4.8	6.7	46	0.72
AMGEN-DIAGNOSTICS	401.5	-5	789.6	-4	8.1	NM	12.1	NM	2.0	NM	NM	NA	NA
AMGEN-HEALTHCARE (7)	2351.4	16	4588.3	15	-205.5	NM	-271.4	NM	NM	2.8	-2.1	NM	-0.24
AMGEN-WISCONSIN SERVICES	406.4**	45	820.7	46	5.6	74	8.9	156	1.4	1.1	5.1	33	1.07
AMGEN-ERSAL HEALTH SERVICES	343.8**	22	684.0	25	16.9	38	38.4	39	4.9	4.3	12.8	22	1.85
AMGEN-OR	778.3	23	1459.0	16	37.0	20	71.0	21	4.8	4.9	6.9	50	0.84
MEDICAL PRODUCTS													
INDUSTRY COMPOSITE	14672.6	7	29100.4	8	1898.6	11	3586.3	4	12.9	12.5	25.7	30	2.04
AMGEN LABORATORIES	2900.4	7	5900.2	10	521.5	11	1056.4	11	18.0	17.4	40.9	25	2.57
AMGEN (C. R.)	304.0	3	604.7	3	26.2	-5	52.3	-4	8.6	9.3	15.2	23	1.58
AMGEN & LOMB	523.2	-4	974.4	-4	20.3	-33	23.5	-55	3.9	5.5	6.3	44	0.96
AMGEN-INTERNATIONAL	1569.0	18	3012.0	14	162.0	14	-41.0	NM	10.3	10.6	10.9	62	0.93
AMGEN, DICKINSON (3)	706.5	2	1405.7	1	70.1	-9	152.8	1	9.9	11.1	23.3	24	2.27
AMGEN-SCIENTIFIC	473.7	25	904.3	25	-26.9	NM	48.5	218	NM	3.5	19.6	68	1.09
AMGEN-ANT	281.0	6	546.5	6	9.0	NM	52.2	NM	3.2	NM	28.0	47	1.88
AMGEN-SON & JOHNSON	5698.0	6	11413.0	7	909.0	15	1818.0	15	16.0	14.7	28.0	26	2.34
AMGEN-TRONIC (8)	640.5**	7	1239.2	10	145.5	20	274.2	20	22.7	20.4	30.4	41	2.22
AMGEN-S & MINOR	776.7	4	1526.3	0	5.8	97	10.8	142	0.7	0.4	10.8	32	0.45
AMGEN-JDE MEDICAL	261.5	19	511.8	18	8.8	-71	31.6	-47	3.4	13.6	5.1	74	0.55
AMGEN-KER	248.0	10	487.6	10	29.4	20	59.4	20	11.8	10.9	21.4	35	1.19
AMGEN-SURGICAL	290.0	2	574.6	5	17.9	-34	47.6	-1	6.2	9.6	8.4	26	1.44
HOUSING & REAL ESTATE													
INDUSTRY COMPOSITE	16021.2	6	29769.8	6	1009.7	289	1561.3	234	6.3	1.7	22.4	16	2.47
BUILDING MATERIALS													
INDUSTRY COMPOSITE	11038.3	8	20438.0	8	842.1	283	1269.2	250	7.6	2.2	27.3	16	2.63
AMGEN STANDARD	1589.0	5	2950.0	2	73.0	25	107.0	NM	4.6	3.9	NM	18	2.68
AMGEN-RGE	476.9	13	720.9	15	59.9	38	25.7	408	12.6	10.3	15.1	12	2.30
AMGEN-CO	913.0	16	1767.0	14	91.6	35	175.1	35	10.0	8.6	18.0	20	2.12
AMGEN-TEK	249.6	-4	469.2	-3	6.7	16	10.4	27	2.7	2.2	21.0	11	2.41

CORPORATE SCOREBOARD

COMPANY	SALES			PROFITS				MARGINS			RETURN ON COMMON EQUITY 12 MONTHS ENDING 6-30	PRICE-EARNINGS RATIO 7-25	MO. EARLY F. ST.
	2ND QUARTER 1997 \$ MIL	CHANGE FROM 1996 %	6 MONTHS 1997 \$ MIL	CHANGE FROM 1996 %	2ND QUARTER 1997 \$ MIL	CHANGE FROM 1996 %	6 MONTHS 1997 \$ MIL	CHANGE FROM 1996 %	2ND QUARTER 1997 %	2ND QUARTER 1996 %			
OWENS CORNING	1017.0	6	1892.0	5	63.0	NM	105.0	NM	6.2	NM	NM	9	4
PPG INDUSTRIES	1944.0	2	3720.6	2	218.0	-5	384.0	-4	11.2	12.0	29.5	16	3
RPM (7)	408.1	29	705.2	23	28.3	15	35.8	10	6.9	7.8	16.4	19	1
SHERWIN-WILLIAMS	1373.4	20	2443.1	22	93.2	14	116.3	15	6.8	7.2	17.4	22	1
TECUMSEH PRODUCTS	480.6	-2	960.2	-3	31.8	-6	63.3	2	6.6	6.9	11.3	11	5
TEXAS INDUSTRIES (7)	281.6**	9	500.0	1	27.6	9	37.7	-9	9.8	9.9	16.7	9	3
USG	723.0	13	1396.0	12	27.0	575	42.0	NM	3.7	0.6	NM	32	1
VALSPAR (2)	252.8	21	442.1	18	17.1	21	25.0	23	6.8	6.8	22.7	23	1
VULCAN MATERIALS	445.1	6	786.4	8	62.8	7	84.7	8	14.1	14.0	21.4	15	5
YORK INTERNATIONAL	884.4	3	1685.2	6	42.2	-8	57.1	-18	4.8	5.3	17.5	15	3
(B) CONSTRUCTION & REAL ESTATE													
GROUP COMPOSITE	4982.9	0	9331.8	4	167.6	322	292.1	176	3.4	0.8	12.9	14	1
CENTEX (9)	861.4**	-3	1813.2	6	27.0	24	56.1	49	3.1	2.4	13.4	14	3
CHAMPION ENTERPRISES	456.0	6	834.9	8	18.2	-5	32.0	-3	4.0	4.5	21.5	15	1
FLEETWOOD ENTERPRISES (8)	746.4	-3	1374.4	-2	21.2	67	34.9	26	2.8	1.6	20.3	13	2
KAUFMAN & BROAD HOME (1)	414.2	14	760.6	-3	10.7	NM	15.1	NM	2.6	NM	14.3	18	1
LENNAR (1)	310.7**	20	582.8	20	22.0	20	41.4	17	7.1	7.1	12.6	14	2
M. D. C. HOLDINGS	237.3**	0	431.1	-1	5.1	13	8.7	-2	2.2	1.9	9.7	8	1
OAKWOOD HOMES (3)	292.4**	11	512.7	6	22.5	26	40.2	18	7.7	6.8	16.8	16	1
PULTE	576.3**	-2	1008.0	-1	12.7	-23	13.9	-35	2.2	2.8	7.2	16	2
RYLAND GROUP	399.6	-4	729.1	-2	3.9	-29	5.6	-12	1.0	1.3	4.4	17	0
U. S. HOME	340.5**	16	656.6	16	11.0	10	21.2	9	3.2	3.4	11.7	8	3
WEBB (DEL) (6)	348.0**	0	628.3	4	13.3	12	22.9	NM	3.8	3.4	13.8	8	2
14 LEISURE TIME INDUSTRIES													
INDUSTRY COMPOSITE	27169.8	7	52511.3	9	2086.7	2	3323.3	8	7.7	8.0	13.1	27	1
(A) EATING PLACES													
GROUP COMPOSITE	5708.2	8	11094.1	9	448.5	-21	861.8	-11	7.9	10.7	15.9	24	1
BRINKER INTERNATIONAL (6)	370.2	24	715.7	23	19.1	4	32.5	0	5.2	6.2	11.4	21	0
CRACKER BARREL OLD COUNTRY STORE (5)	275.1	25	542.9	23	20.5	26	36.5	27	7.5	7.4	11.7	20	1
DARDEN RESTAURANTS (7)	816.7	-2	1617.5	0	-116.1	NM	-100.3	NM	NM	4.2	-8.4	NM	-0
HOT MARRIOTT SERVICES	292.6	1	555.7	1	5.1	55	0.8	NM	1.7	1.1	NM	28	0
MCDONALD'S	2832.6	6	5450.2	7	438.2	4	782.7	8	15.5	15.8	19.0	23	2
OUTBACK STEAKHOUSE	287.7	22	558.8	23	19.3	6	36.5	4	6.7	7.7	20.2	17	1
SHONEY'S (2)	293.1	14	654.2	18	5.3	-18	-8.5	NM	1.8	2.5	NM	24	0
WENDY'S INTERNATIONAL	540.2	10	999.1	11	57.0	16	81.6	19	10.6	10.0	15.4	22	1
(B) HOTEL & MOTEL													
GROUP COMPOSITE	5939.4	23	11451.2	24	310.6	15	536.6	12	5.2	5.6	10.1	33	0
CIRCUS CIRCUS ENTERPRISES (11) †	318.8	-4	600.7	-6	37.5	-14	52.6	-33	11.8	13.1	9.3	25	0
HARRAH'S ENTERTAINMENT	408.9	2	783.0	0	25.4	-15	42.5	-31	6.2	7.5	11.4	27	0
HILTON HOTELS	1360.0	35	2663.0	36	93.0	58	161.0	68	6.8	5.9	6.6	34	0
HOT MARRIOTT	270.0**	62	522.0	76	26.0	271	32.0	NM	9.6	4.2	2.1	NM	0
MARRIOTT INTERNATIONAL	2878.0	22	5482.0	21	83.0	11	160.0	16	2.9	3.2	24.8	29	2
MIRAGE RESORTS	335.6	6	690.2	0	48.9	20	105.6	0	14.6	12.8	15.3	24	1
TRUMP HOTELS & CASINO RESORTS	368.0	57	710.3	125	-3.2	NM	-17.2	NM	NM	6.3	-7.5	NM	-1
(C) OTHER LEISURE													
GROUP COMPOSITE	15522.2	2	29965.9	5	1327.6	11	1925.0	17	8.6	7.9	12.9	27	1
AMERICAN GREETINGS (10)	475.1	8	1083.7	10	30.3	9	83.6	14	6.4	6.3	12.2	15	2
BRUNSWICK	1008.2	17	1849.8	16	82.9	19	135.6	17	8.2	8.1	16.5	16	2
CALLAWAY GOLF	253.0	21	422.1	22	46.8	20	71.3	22	18.5	18.5	36.4	18	1
CARNIVAL (1)	596.6	15	1117.7	16	127.4	20	212.8	16	21.4	20.6	18.4	21	2
DISNEY (WALT) (3)	5194.0	2	10675.0	11	473.0	17	806.0	111	9.1	8.0	11.2	29	2
EASTMAN KODAK	3853.0	-6	6986.0	-7	368.0	-16	517.0	-28	9.6	10.7	18.7	27	2
HARLEY-DAVIDSON	444.1**	13	871.2	14	49.2	23	89.5	23	11.1	10.2	23.0	25	2
HASBRO	583.9	14	1139.7	9	13.0	117	38.7	27	2.2	1.2	12.7	19	1
IMATION	554.8	1	1102.5	-3	4.4	NM	16.4	NM	0.8	NM	3.2	33	0
MATTEL	972.7	6	1666.2	4	75.6	19	-129.0	NM	7.8	6.9	9.0	62	0
MUSICLAND STORES	342.7	-8	718.8	-5	-18.3	NM	-39.3	NM	NM	NM	NM	NM	5
OUTBOARD MARINE (3)	275.8	-5	512.8	11	-5.1	NM	-12.4	NM	NM	NM	-9.4	NM	-0
POLAROID	564.9	-3	1022.4	-2	34.5	21	50.4	NM	6.1	4.9	15.3	27	2
ROYAL CARIBBEAN CRUISES	403.5	14	798.1	19	45.9	20	84.4	19	11.4	10.8	14.7	15	2
15 MANUFACTURING													
INDUSTRY COMPOSITE	49389.1	10	93456.2	9	3503.2	10	5774.6	2	7.1	7.1	19.7	22	2
(A) GENERAL MANUFACTURING													
GROUP COMPOSITE	16950.4	9	32734.9	9	1401.1	7	2440.7	8	8.3	8.5	22.4	24	2
AEROQUIP-VICKERS	556.3	7	1094.7	6	33.6	2	39.3	-32	6.0	6.4	19.2	19	2
EVERETT DENNISON	844.8	6	1673.7	5	49.6	19	97.8	20	5.9	5.2	23.3	23	1
CARLISLE	337.4	29	625.2	28	21.0	28	34.4	27	6.2	6.3	20.3	21	2
COLTEC INDUSTRIES	322.2	10	631.4	10	23.8	47	45.3	177	7.4	5.5	NM	18	1

CORPORATE SCOREBOARD

COMPANY	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY 12 MONTHS ENDING 6-30	PRICE-EARNINGS RATIO 7-25	12 MONTHS' EARNINGS PER SHARE
	2ND QUARTER 1997 \$ MIL	CHANGE FROM 1996 %	6 MONTHS 1997 \$ MIL	CHANGE FROM 1996 %	2ND QUARTER 1997 \$ MIL	CHANGE FROM 1996 %	6 MONTHS 1997 \$ MIL	CHANGE FROM 1996 %	2ND QUARTER 1997 %	2ND QUARTER 1996 %			
ING	1040.6**	13	1996.5	13	127.0	35	219.0	40	12.2	10.2	35.5	34	1.78
E (W. R.)	842.5	-8	1627.6	-9	117.4	-50	163.8	-41	13.9	25.5	32.4	35	1.67
EL	241.6	45	455.6	55	15.1	NM	23.4	NM	6.3	NM	14.1	32	0.76
NBRAND INDUSTRIES (1)	426.0	0	872.0	2	37.0	10	76.0	13	8.7	7.9	18.6	21	2.16
JIS TOOL WORKS	1326.3	0	2556.1	4	154.4	18	277.6	21	11.6	9.8	20.7	24	2.15
SON CONTROLS (3)	2879.3	16	5622.9	19	74.4	17	72.8	-27	2.6	2.6	13.5	18	2.37
IV INDUSTRIES (10)	560.1	4	1079.3	0	30.1	10	53.6	12	5.4	5.0	4.9	44	0.55
ESOTA MINING & MFG.	3817.0	8	7531.0	8	418.0	10	828.0	11	11.0	10.8	25.7	25	3.84
LL	800.9	9	1430.3	6	77.8	15	115.6	15	9.7	9.2	18.0	25	1.71
ER HANNIFIN (6)	1115.1	12	2162.2	12	92.4	43	170.4	27	8.3	6.5	18.4	16	3.68
RIS INDUSTRIES	249.9	-21	474.5	-20	13.3	-18	25.3	-14	5.3	5.1	38.3	14	2.11
ERMAID	640.4	12	1242.1	12	46.6	4	80.6	-7	7.3	7.8	14.3	26	0.98
LEX	280.3	18	549.6	16	18.3	21	35.0	17	6.5	6.4	14.7	20	1.69
R AUTOMOTIVE	327.3	239	452.4	173	13.2	149	19.9	134	4.0	5.5	6.6	22	1.91
ERWARE	342.5	-10	657.8	-7	38.0	-25	62.9	-23	11.1	13.4	57.7	15	2.47
MACHINE & HAND TOOLS													
JP COMPOSITE	4391.4	3	8345.4	2	136.3	-36	321.5	-3	3.1	5.0	13.1	23	1.90
K & DECKER	1182.2	-2	2197.2	-3	45.5	0	71.8	457	3.8	3.8	13.0	19	2.28
NNATI MILACRON	452.1	10	829.6	8	18.2	24	31.2	14	4.0	3.6	15.9	16	1.75
HER	502.8	16	969.2	15	38.3	18	69.8	17	7.6	7.5	16.6	23	2.30
AMETAL (6)	312.3	12	607.7	7	22.3	18	42.3	0	7.2	6.7	15.9	17	2.71
ILN ELECTRIC	299.6	5	580.4	3	22.7	12	43.7	19	7.6	7.1	19.6	12	3.27
O INDUSTRIES	541.1	-4	1020.8	9	14.9	6	17.7	-34	2.8	2.5	11.0	14	4.84
-ON	427.6**	7	820.4	8	39.0	13	72.8	13	9.1	8.6	16.3	18	2.31
LEY WORKS	673.6	-1	1320.2	1	-64.5	NM	-27.8	NM	NM	4.8	0.9	NM	0.08
SPECIAL MACHINERY													
UP COMPOSITE	23251.9	13	43056.3	10	1793.6	21	2708.0	-1	7.7	7.2	19.9	20	2.89
	871.9	49	1576.3	52	48.7	30	76.6	32	5.6	6.4	15.7	12	2.48
IED MATERIALS (2)	900.9	-20	1736.6	-20	102.1	-45	131.7	-63	11.3	16.5	14.9	44	2.03
	1601.0**	9	2833.0	7	138.0	25	202.0	9	8.6	7.5	16.7	13	4.79
RPILLAR	4870.0	17	9132.0	14	435.0	16	829.0	24	8.9	8.9	34.8	14	3.99
E (2)	3521.1**	14	5917.1	9	319.5	17	496.2	13	9.1	8.8	23.6	17	3.41
R	1154.0	13	2162.8	7	124.9	42	203.4	23	10.8	8.6	28.5	19	3.81
SER INDUSTRIES (2)	1763.2	8	3456.7	12	74.8	31	126.9	22	4.2	3.5	17.4	25	1.59
	1455.4	16	2735.8	17	72.8	27	112.7	-1	5.0	4.6	25.1	14	5.68
SISCHFEGER INDUSTRIES (2)	807.1	9	1515.3	9	45.0	34	75.8	34	5.6	4.5	17.5	15	2.80
RSOLL-RAND	1837.4	4	3476.8	3	111.6	21	189.4	14	6.1	5.2	18.0	18	3.52
RESEARCH (6)	262.7	-30	478.3	-34	-2.0	NM	-46.7	NM	NM	10.2	-5.7	NM	-1.10
ERMOTT INTERNATIONAL (9)	928.1	6	1660.5	-4	109.9	NM	-80.0	NM	11.8	NM	-22.3	NM	-1.80
AIR	422.3	16	833.4	14	20.5	20	39.9	19	4.9	4.7	14.4	19	1.99
VART & STEVENSON SERVICES (11)	329.4	50	719.5	38	9.9	47	20.5	0	3.0	3.1	4.1	41	0.61
EN	676.0	12	1316.6	10	44.9	30	86.0	26	6.6	5.7	15.9	14	2.50
I INTERNATIONAL (6)	1851.3	35	3505.6	33	137.9	46	244.6	41	7.5	6.9	14.7	31	2.61
TEXTILES													
UP COMPOSITE	4795.4	6	9319.7	8	172.2	-1	304.3	-25	3.6	3.9	14.1	19	1.25
INGTON INDUSTRIES (3)	553.6	-4	1090.8	-5	13.5	NM	34.6	63	2.4	0.1	9.1	15	0.90
INS & AIKMAN	416.0	37	831.6	48	11.6	-26	22.9	-87	2.8	5.2	NA	NA	NA
ER	293.2	3	565.5	0	16.0	11	28.9	13	5.5	5.0	14.4	17	2.24
CREST CANNON	270.8	-3	533.7	1	6.8	222	8.9	511	2.5	0.8	1.8	54	0.42
FORD MILLS (3)	238.4	3	457.5	4	14.5	15	22.0	19	6.1	5.4	13.0	12	1.85
RFACE	271.7	14	529.1	20	8.0	32	14.3	47	2.9	2.5	10.1	19	1.37
AWK INDUSTRIES	479.2	1	892.0	4	19.3	18	27.9	28	4.0	3.5	15.2	16	1.59
N INDUSTRIES	915.2	16	1723.9	19	25.2	-10	36.0	187	2.8	3.6	8.2	25	0.43
NGS INDUSTRIES	528.9	-2	1071.9	-4	15.1	-65	26.3	-52	2.9	8.0	7.5	17	2.90
I (6)	432.6	-1	870.9	7	31.5	18	62.9	32	7.3	6.1	21.1	20	1.81
TPOINT STEVENS	395.8	9	752.9	9	10.7	17	19.7	13	2.7	2.5	NM	20	1.89
METALS & MINING													
USTRY COMPOSITE	23323.3	7	45246.6	6	1369.8	42	2341.0	38	5.9	4.4	11.3	20	1.78
ALUMINUM													
UP COMPOSITE	7232.1	-1	13959.0	-1	344.0	15	576.1	-5	4.8	4.1	9.4	28	2.22
MAX	730.9	-14	1432.7	-13	35.8	-57	62.5	-65	4.9	9.8	7.6	16	2.56
MINUM CO. OF AMERICA	3432.0	1	6663.1	2	207.6	57	366.7	18	6.0	3.9	12.8	26	3.28
ER ALUMINUM	597.1	5	1144.5	4	13.7	67	16.3	-10	2.3	1.4	-2.8	NM	-0.03
XAM	689.1	3	1320.7	3	31.9	89	32.6	44	4.6	2.5	NM	15	3.50
MOLDS METALS	1783.0	-2	3398.0	-3	55.0	-8	98.0	27	3.1	3.3	4.0	50	1.48
STEEL													
UP COMPOSITE	11101.2	6	21536.6	6	598.6	94	954.0	141	5.4	3.0	10.9	17	1.30
STEEL HOLDING	622.6	8	1221.4	8	39.0	1	73.5	-3	6.3	6.7	16.0	9	4.99
ICO	490.3	9	931.6	6	20.2	NM	29.6	921	4.1	NM	NM	16	0.32
HLEHEM STEEL	1206.9	-2	2399.4	2	160.0	502	198.4	643	13.3	2.2	-18.2	NM	-1.61
PENTER TECHNOLOGY (6)	284.7	20	535.6	14	22.8	7	38.3	6	8.0	8.9	13.8	14	3.30

CORPORATE SCOREBOARD

COMPANY	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY 12 MONTHS ENDING 6-30	PRICE-EARNINGS RATIO 7-25	1 YEAR % CHG. P. SH.
	2ND QUARTER 1997 \$ MIL	CHANGE FROM 1996 %	6 MONTHS 1997 \$ MIL	CHANGE FROM 1996 %	2ND QUARTER 1997 \$ MIL	CHANGE FROM 1996 %	6 MONTHS 1997 \$ MIL	CHANGE FROM 1996 %	2ND QUARTER 1997 %	2ND QUARTER 1996 %			
COMMERCIAL METALS (4)	589.6**	-8	1115.4	4	9.5	-21	16.7	-24	1.6	1.9	11.4	12	2.1
INLAND STEEL INDUSTRIES	1321.2	14	2528.5	8	40.1	19	71.3	40	3.0	2.9	9.5	14	1.0
LTV	1092.2	2	2164.1	5	27.1	-15	53.9	19	2.5	3.0	6.7	12	1.1
LUKENS	258.2	1	506.4	3	1.2	NM	-0.8	NM	0.5	NM	-9.1	NM	-1.3
NATIONAL STEEL	824.9	7	1582.5	9	62.5	502	88.4	NM	7.6	1.4	22.0	6	2.3
NUCOR	1035.1	14	2045.6	14	73.0	32	138.0	28	7.1	6.1	16.7	19	3.2
ROUGE STEEL	355.2	2	689.4	3	10.6	-10	19.9	8	3.0	3.4	5.7	16	1.1
USX-U. S. STEEL GROUP	1721.0	9	3341.0	5	97.0	203	184.0	136	5.6	2.0	22.2	8	4.2
WALTER INDUSTRIES (7)	399.1	0	739.5	2	21.6	-46	19.4	NM	5.4	10.0	11.6	27	0.6
WEIRTON STEEL	363.6	8	713.2	5	-12.9	NM	-25.2	NM	NM	NM	-30.4	NM	-1.0
WORTHINGTON INDUSTRIES (7)	536.5	14	1023.1	19	26.9	1	48.7	-4	5.0	5.7	13.4	20	0.9
(C) OTHER METALS													
GROUP COMPOSITE	4990.0	21	9751.0	19	427.2	20	810.9	17	8.6	8.6	13.8	17	2.2
ASARCO	741.0	9	1456.6	3	51.9	-28	92.5	-14	7.0	10.6	6.8	12	2.8
COMMONWEALTH INDUSTRIES	287.2	80	559.4	71	4.2	98	6.3	41	1.5	1.3	7.2	13	1.0
CYPRUS AMAX MINERALS	841.0	14	1729.0	21	66.0	25	123.0	7	7.8	7.2	2.8	35	0.8
ESSEX INTERNATIONAL	453.3	34	864.1	34	23.4	208	42.7	205	5.2	2.3	38.5	16	2.0
FREEPORT-McMORAN COPPER & GOLD	567.0	34	1090.7	34	79.1	85	150.9	91	13.9	10.1	78.5	21	1.2
GENERAL CABLE	292.2	8	543.2	3	12.0	20	20.6	65	4.1	3.7	52.1	17	1.9
HARSCO †	426.3	10	817.0	8	36.4	24	66.5	10	8.5	7.5	18.3	17	2.5
PHELPS DODGE	1065.0	11	2086.7	6	134.8	7	272.3	-3	12.7	13.2	17.3	12	7.0
PRECISION CASTPARTS (9)	317.0	91	604.3	87	19.5	73	36.1	66	6.2	6.8	12.8	22	2.8
17 NONBANK FINANCIAL													
INDUSTRY COMPOSITE	100945.5	11	197332.2	12	9781.0	19	19079.8	20	9.7	9.1	16.6	19	3.4
(A) FINANCIAL SERVICES													
GROUP COMPOSITE	57941.3	15	112763.6	15	5515.7	10	10593.3	11	9.5	9.9	20.7	18	3.0
ALEX. BROWN	261.2**	-16	494.7	-15	31.7	-36	62.8	-31	12.1	16.1	18.0	16	5.0
ALLEGHANY	548.6	4	1053.3	6	33.9	49	46.8	18	6.2	4.3	7.1	17	12.8
AMERICAN EXPRESS	4422.0**	8	8585.0	8	520.0	15	974.0	15	11.8	11.1	24.2	19	4.2
ASSOCIATES FIRST CAPITAL	2049.5	19	3976.2	18	245.0	22	482.8	23	12.0	11.7	16.3	23	2.7
BEAR STEARNS (6)	1773.3	26	3284.6	22	162.9	0	328.4	13	9.2	11.6	23.2	9	4.2
BLOCK (H&R) (8)	1085.9**	18	1449.0	17	199.4	7	174.1	-3	18.4	20.1	5.8	84	0.4
CAPITAL ONE FINANCIAL	395.9	28	807.6	32	39.4	3	81.8	7	9.9	12.4	19.6	15	2.3
COUNTRYWIDE CREDIT INDUSTRIES (10)	426.4	46	725.7	21	70.0	15	138.3	17	16.4	20.8	15.8	13	2.4
DONALDSON, LUFKIN & JENRETTE	1061.2	7	2042.6	16	100.2	3	186.6	15	9.4	9.8	19.6	13	4.9
DUN & BRADSTREET	498.3	-1	957.3	0	50.2	NM	88.2	NM	10.1	NM	NM	53	0.5
EDWARDS (A. G.) (10)	439.3	3	895.7	7	54.5	-3	113.9	8	12.4	13.2	16.7	12	3.3
EQUIFAX	343.0	14	655.0	11	61.2	77	99.7	49	17.8	11.5	45.1	23	1.4
FANNIE MAE	6862.8**	12	13535.0	11	751.3	11	1485.7	10	10.9	11.0	24.0	17	2.6
FEDERAL HOME LOAN MORTGAGE	3604.0	20	7015.0	22	340.0	5	669.0	7	9.4	10.8	18.1	20	1.7
FINOVA GROUP	239.0	23	459.3	17	33.8	17	65.4	18	14.1	14.9	13.6	19	4.5
FIRST AMERICAN FINANCIAL	450.4**	9	833.3	10	18.5	-5	21.4	-24	4.1	4.7	13.3	10	4.0
FRANKLIN RESOURCES (3)	577.9**	46	1099.7	39	111.2	37	212.6	36	19.2	20.5	23.9	27	3.1
GREEN TREE FINANCIAL	317.1**	62	584.3	60	108.1	43	199.9	41	34.1	38.5	27.5	17	2.6
HOUSEHOLD INTERNATIONAL	1293.3	-1	2579.0	4	150.3	21	281.8	20	11.6	9.5	18.8	20	5.7
LEHMAN BROTHERS HOLDINGS (1)	3806.0	10	7805.0	14	121.0	12	265.0	25	3.2	3.1	12.0	14	3.6
MARSH & MCLENNAN	1449.8	40	2658.5	26	145.0	26	309.4	20	10.0	11.1	17.0	22	3.3
MERRILL LYNCH	8011.0	29	15462.0	27	481.0	11	947.0	12	6.0	7.0	25.8	15	4.4
MORGAN STANLEY, DEAN WITTER, DISCOVER (1)	6376.0	14	12936.0	17	527.0	-7	1098.0	3	8.3	10.1	NA	NA	NM
PAINWEBBER GROUP	1619.8**	13	3147.5	10	93.1	1	194.0	1	5.8	6.4	20.0	11	3.6
SALLIE MAE	937.7	6	1859.8	4	119.2	16	238.0	13	12.7	11.6	52.3	18	8.1
SALOMON	2455.0**	4	4639.0	-5	220.0	-26	393.0	-35	9.0	12.6	15.6	9	6.5
SCHWAB (CHARLES)	663.9	12	1322.7	16	64.0	-9	130.7	12	9.6	11.8	26.4	35	1.3
TRAVELERS GROUP	5973.1	10	11901.1	20	662.9	15	1305.0	19	11.1	10.6	19.9	18	3.7
(B) INSURANCE													
GROUP COMPOSITE	40099.2	7	78845.8	8	3897.9	32	7774.5	33	9.7	7.9	14.1	19	4.0
AFLAC	1741.5	0	3449.0	-1	302.8	253	393.0	128	17.4	4.9	26.8	13	4.3
ALLSTATE	6073.0	4	12252.0	0	643.0	-16	1410.0	19	10.6	12.1	17.4	15	5.1
AMERICAN FINANCIAL GROUP	969.0	4	1899.0	-5	61.2	5	124.4	-11	6.3	5.8	16.7	11	4.0
AMERICAN GENERAL	2226.0	2	4368.0	1	-124.0	NM	86.0	-76	NM	7.5	NA	33	1.5
AMERICAN INTERNATIONAL GROUP	7137.3**	11	13746.6	10	826.5	14	1607.4	15	11.6	11.3	13.9	23	4.4
AMERICAN NATIONAL INSURANCE	434.5	15	862.9	14	57.4	24	120.2	35	13.2	12.2	10.0	10	9.3
AMERICAN STATES FINANCIAL	510.3	2	1012.2	0	44.2	49	98.2	28	8.7	6.0	14.4	15	3.1
CIGNA	4719.0**	0	9364.0	0	279.0	21	567.0	21	5.9	4.9	16.2	12	15.3
CINCINNATI FINANCIAL	484.2	10	967.9	8	75.8	39	149.9	32	15.7	12.3	6.9	18	4.5
CONSECO	1360.5	102	2459.6	80	132.8	165	247.6	118	9.8	7.5	10.9	18	2.2
EVEREST REINSURANCE HOLDINGS	319.1	18	606.6	15	44.3	54	78.8	40	13.9	10.7	11.5	13	2.6
LIBERTY FINANCIAL	304.4	12	614.7	13	30.0	30	65.0	39	9.9	8.5	10.5	13	3.8

CORPORATE SCOREBOARD

COMPANY	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY 12 MONTHS ENDING 6-30	PRICE-EARNINGS RATIO 7-25	12 MONTHS' EARNINGS PER SHARE
	2ND QUARTER 1997 \$ MIL	CHANGE FROM 1996 %	6 MONTHS 1997 \$ MIL	CHANGE FROM 1996 %	2ND QUARTER 1997 \$ MIL	CHANGE FROM 1996 %	6 MONTHS 1997 \$ MIL	CHANGE FROM 1996 %	2ND QUARTER 1997 %	2ND QUARTER 1996 %			
ALCOHOL NATIONAL CASUALTY	1128.1	-1	2326.1	2	-48.0	NM	35.1	-80	NM	7.5	8.1	24	2.85
AMERICAN PUBLIC INTERNATIONAL	361.4	0	721.0	0	33.0	161	64.2	315	9.1	3.5	11.9	11	4.19
AMERICAN CAPITAL	492.6	9	954.4	8	88.3	55	153.5	39	17.9	12.6	14.3	11	2.91
AMERICAN SOUTHERN	390.1	6	775.0	8	25.4	23	54.9	43	6.5	5.6	16.3	11	3.71
AMERICAN SOUTHERN	1118.8**	32	2085.3	27	102.1	30	178.6	26	9.1	9.2	20.1	21	4.70
AMERICAN SOUTHERN	1084.3**	5	2114.5	5	117.2	11	228.7	6	10.8	10.3	11.2	13	3.57
AMERICAN SOUTHERN	1620.7	19	3177.9	18	230.5	70	422.8	51	14.2	9.9	18.0	11	7.64
AMERICAN SOUTHERN (3)†	576.8**	43	1034.3	38	94.3	35	181.2	31	16.4	17.3	20.8	25	2.39
AMERICAN SOUTHERN	434.0	-5	862.0	-6	38.8	16	75.3	NM	8.9	7.3	12.4	11	2.64
AMERICAN SOUTHERN	1584.1	5	3123.5	4	387.9	266	468.9	112	24.5	7.0	17.1	9	10.42
AMERICAN SOUTHERN	361.2	18	699.6	21	43.1	14	84.8	15	11.9	12.3	13.3	15	4.80
AMERICAN SOUTHERN	2430.9	10	4862.2	45	276.0	NM	549.1	NM	11.4	NM	16.7	16	2.65
AMERICAN SOUTHERN	390.5	2	772.6	1	1.2	-96	34.9	-36	0.3	7.7	7.6	21	3.01
AMERICAN SOUTHERN	974.5	-2	2017.5	1	87.6	19	202.6	39	9.0	7.5	13.8	22	2.07
AMERICAN SOUTHERN	872.4	2	1717.4	0	47.4	-29	92.4	-25	5.4	7.8	12.9	13	1.89
SAVINGS & LOAN													
AMERICAN SOUTHERN	2905.1	9	5722.7	7	367.5	27	712.0	27	12.6	10.8	11.2	23	2.75
AMERICAN SOUTHERN (H. F.)	963.3	4	1914.3	2	115.7	68	218.7	64	12.0	7.4	8.0	28	1.92
AMERICAN SOUTHERN	280.8	7	551.7	7	45.7	11	89.8	13	16.3	15.8	14.1	19	2.91
AMERICAN SOUTHERN	710.0	9	1403.6	7	87.3	10	170.7	8	12.3	12.3	15.4	12	6.63
AMERICAN SOUTHERN	951.0**	14	1853.1	12	118.8	19	232.8	24	12.5	11.9	8.8	58	1.14
OFFICE EQUIPMENT & COMPUTERS													
AMERICAN SOUTHERN	87757.6	12	171411.3	12	6454.1	39	12346.8	55	7.4	5.9	21.1	33	1.95
BUSINESS MACHINES & SERVICES													
AMERICAN SOUTHERN	6360.8	11	12401.0	11	273.1	6	537.2	16	4.3	4.5	17.3	27	1.52
AMERICAN SOUTHERN	491.2	-3	923.1	0	8.0	-35	12.9	-29	1.6	2.4	15.0	19	0.51
AMERICAN SOUTHERN	440.3	-6	906.8	-5	37.5	-2	78.9	38	8.5	8.2	11.9	32	1.07
AMERICAN SOUTHERN	303.2	22	567.8	22	30.7	26	54.4	28	10.1	9.8	18.5	29	1.59
AMERICAN SOUTHERN	296.6	35	579.4	28	18.8	53	35.8	23	6.4	5.6	28.2	23	2.50
AMERICAN SOUTHERN	668.3	-24	1408.2	-22	-11.9	NM	-16.9	NM	NM	NM	-92.0	NM	-3.18
AMERICAN SOUTHERN	1035.7	20	1896.0	15	6.0	94	10.7	125	0.6	0.4	9.6	19	1.24
AMERICAN SOUTHERN	411.2	20	776.3	19	27.4	61	41.0	41	6.7	5.0	24.0	32	1.55
AMERICAN SOUTHERN	1006.1	7	1967.5	6	131.1	11	251.0	12	13.0	12.6	23.7	22	3.33
AMERICAN SOUTHERN	338.1	18	692.3	27	7.3	-70	33.5	-29	2.2	8.5	20.7	19	0.99
AMERICAN SOUTHERN	1370.1	39	2683.6	42	18.2	75	36.0	83	1.3	1.1	14.1	24	1.49
COMPUTERS & PERIPHERALS													
AMERICAN SOUTHERN	63621.9	8	124059.6	8	4134.7	51	7519.9	75	6.5	4.7	21.1	25	2.42
AMERICAN SOUTHERN	1737.0	-20	3338.0	-24	-56.0	NM	-764.0	NM	NM	NM	-71.8	NM	-6.85
AMERICAN SOUTHERN	5012.0	25	9817.0	20	214.0	-20	601.0	20	4.3	6.7	20.7	27	2.01
AMERICAN SOUTHERN	391.3	21	780.7	19	14.7	106	28.5	111	3.8	2.2	13.3	26	1.15
AMERICAN SOUTHERN	2588.0	58	5000.0	57	198.0	141	386.0	154	7.7	5.0	75.5	47	1.72
AMERICAN SOUTHERN	3463.1	-7	6777.4	-8	123.9	NM	174.9	NM	3.6	NM	3.0	61	0.68
AMERICAN SOUTHERN	713.5	31	1331.9	25	128.8	48	239.7	40	18.1	16.0	24.0	27	1.81
AMERICAN SOUTHERN	1392.7	22	2812.0	23	56.5	10	124.0	22	4.1	4.5	28.8	23	1.74
AMERICAN SOUTHERN	10340.0	5	20635.0	8	784.0	8	1696.0	12	7.6	7.3	18.7	25	2.64
AMERICAN SOUTHERN	18872.0	4	36180.0	4	1446.0	7	2641.0	25	7.7	7.4	30.1	18	5.83
AMERICAN SOUTHERN	400.2	41	761.5	51	26.2	86	49.2	103	6.6	5.0	21.4	36	0.61
AMERICAN SOUTHERN	556.3	0	1139.7	0	34.3	11	65.0	24	6.2	5.5	26.3	17	1.84
AMERICAN SOUTHERN	511.4	24	1021.7	18	19.7	40	47.5	NM	3.8	3.4	28.2	17	1.06
AMERICAN SOUTHERN	1645.0	-2	3034.0	-7	-4.0	NM	-20.0	NM	NM	NM	-3.2	NM	-0.45
AMERICAN SOUTHERN	1446.1	25	3010.0	26	96.5	NM	184.2	NM	6.7	0.3	24.2	15	1.87
AMERICAN SOUTHERN	1977.2	-2	4479.0	9	59.3	-41	316.1	NM	3.0	5.0	17.9	15	2.73
AMERICAN SOUTHERN	1162.3	19	2071.7	25	102.4	NM	112.9	NM	8.8	NM	4.3	59	0.43
AMERICAN SOUTHERN	517.0	8	955.6	2	54.0	43	93.6	47	10.4	7.9	14.4	15	3.31
AMERICAN SOUTHERN	2543.1	26	4657.7	21	237.2	94	460.7	73	9.3	6.1	27.8	24	1.96
AMERICAN SOUTHERN	502.6	8	969.9	4	43.2	85	68.2	NM	8.6	5.0	10.6	27	1.00
AMERICAN SOUTHERN	829.9	26	1616.7	28	89.2	202	176.8	70	10.7	4.5	24.6	28	2.02
AMERICAN SOUTHERN	1585.3	5	3116.0	6	41.9	691	61.2	NM	2.6	0.4	10.6	NM	0.08
AMERICAN SOUTHERN	1079.9	32	2176.1	40	87.9	169	170.5	227	8.1	4.0	43.2	13	2.86
AMERICAN SOUTHERN	4356.0	3	8378.0	3	337.0	15	607.0	15	7.7	6.9	28.6	21	3.74
COMPUTER SOFTWARE & SERVICES													
AMERICAN SOUTHERN	17774.9	27	34950.7	27	2046.4	26	4289.7	34	11.5	11.6	21.8	51	1.41
AMERICAN SOUTHERN	311.7	52	604.4	71	-48.8	NM	-212.1	NM	NM	21.6	-17.5	NM	-0.61
AMERICAN SOUTHERN	543.0	1	1055.9	0	-118.0	NM	-117.8	NM	NM	10.3	-23.1	NM	-1.46
AMERICAN SOUTHERN	272.8	8	523.4	10	4.5	-33	11.3	-6	1.6	2.6	9.3	45	0.56
AMERICAN SOUTHERN	362.7	12	743.2	19	58.8	3	119.2	140	16.2	17.7	19.4	23	1.45

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CORPORATE SCOREBOARD

COMPANY	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY 12 MONTHS ENDING 6-30	PRICE- EARNINGS RATIO 7-25	12 MONTH EARNI PER SHA
	2ND QUARTER 1997 \$ MIL.	CHANGE FROM 1996 %	6 MONTHS 1997 \$ MIL.	CHANGE FROM 1996 %	2ND QUARTER 1997 \$ MIL.	CHANGE FROM 1996 %	6 MONTHS 1997 \$ MIL.	CHANGE FROM 1996 %	2ND QUARTER 1997 %	2ND QUARTER 1996 %			
CERIDIAN	404.2	12	818.7	12	48.5	19	92.3	5	12.0	11.3	39.6	18	2.3
CHS ELECTRONICS	947.0	199	1824.1	194	6.4	271	13.1	253	0.7	0.5	16.5	22	1.5
CISCO SYSTEMS (5)	1647.9	52	3240.2	62	378.3	54	716.8	57	23.0	22.6	29.4	46	1.7
COMDISCO (3)	712.0**	20	1402.0	20	34.0	17	67.0	18	4.8	4.9	16.3	19	1.5
COMPUTER ASSOCIATES INTERNATIONAL (9)	890.7	12	2095.7	10	155.8	30	491.8	28	17.5	15.2	26.7	62	1.0
COMPUTER SCIENCES (9)	1488.8	14	3024.0	16	52.6	16	128.3	116	3.5	3.5	12.0	31	2.5
FIRST DATA	1318.2	10	2561.5	10	-28.4	NM	107.8	-56	NM	11.6	13.1	41	1.0
FISERV	238.4	10	466.7	8	20.8	3	43.4	9	8.7	9.3	11.4	32	1.5
GTECH HOLDINGS (10)	245.2	16	491.4	22	19.3	6	42.3	24	7.9	8.6	21.8	16	1.8
INACOM	972.2	26	1813.9	28	6.7	52	12.0	61	0.7	0.6	11.2	16	2.0
INTERGRAPH	288.6	8	541.4	3	-16.0	NM	-42.3	NM	NM	NM	-21.8	NM	-1.8
MICROSOFT (6)	3175.0	41	6383.0	43	1057.0	89	2099.0	87	33.3	24.8	35.1	53	2.6
NOVELL (2)	273.1	45	648.0	4	-14.6	NM	36.2	341	NM	NM	9.4	16	0.4
ORACLE (7)	1948.0	33	3320.6	34	359.9	35	529.2	28	18.5	18.2	34.7	45	1.2
SABRE GROUP HOLDINGS	447.0	9	887.0	6	58.0	18	125.0	5	13.0	12.0	30.2	20	1.4
SAFEGUARD SCIENTIFICS	502.7	-5	950.3	-1	5.6	4	10.1	8	1.1	1.0	11.0	45	0.6
SYBASE	237.6	-5	479.5	-3	4.4	NM	7.9	NM	1.8	NM	-9.4	NM	-0.5
VANSTAR (8)	548.2	13	1075.7	15	1.6	-90	9.2	NM	0.3	3.4	18.6	18	0.6

19 PAPER & FOREST PRODUCTS

INDUSTRY COMPOSITE	26034.3	-1	50945.5	-1	444.4	-56	1198.9	-49	1.7	3.9	6.5	40	1.2
(A) FOREST PRODUCTS													
GROUP COMPOSITE	6781.4	2	13067.1	2	47.2	-45	199.0	-25	0.7	1.3	0.8	NM	0.2
BOISE CASCADE	1333.0	6	2606.6	5	-16.2	NM	-31.4	NM	NM	NM	-5.4	NM	-1.4
GEORGIA-PACIFIC	3326.0	0	6471.0	1	27.0	170	117.0	95	0.8	0.3	6.1	39	2.3
LOUISIANA-PACIFIC	633.3	-4	1187.9	-4	-10.1	NM	31.9	83	NM	3.2	-12.9	NM	-1.7
RAYONIER	290.1	-2	550.2	-7	19.8	29	38.2	-19	6.8	5.2	-1.4	NM	-0.2
UNIVERSAL FOREST PRODUCTS	341.3	24	556.0	28	9.0	10	12.3	14	2.6	3.0	18.6	13	1.0
WILLAMETTE INDUSTRIES	857.7	0	1695.4	-2	17.8	-63	31.1	-74	2.1	5.6	5.1	41	1.8



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CORPORATE SCOREBOARD

COMPANY	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY 12 MONTHS ENDING 6-30	PRICE- EARNINGS RATIO 7-25	12 MONTHS' EARNINGS PER SHARE
	2ND QUARTER 1997 \$ MIL	CHANGE FROM 1996 %	6 MONTHS 1997 \$ MIL	CHANGE FROM 1996 %	2ND QUARTER 1997 \$ MIL	CHANGE FROM 1996 %	6 MONTHS 1997 \$ MIL	CHANGE FROM 1996 %	2ND QUARTER 1997 %	2ND QUARTER 1996 %			
PAPER													
UP COMPOSITE	19252.9	-2	37878.4	-1	397.1	-57	999.9	-52	2.1	4.7	8.0	34	1.44
ATER	356.3	-22	704.8	-24	7.1	-84	6.8	-96	2.0	9.8	4.5	43	1.19
APION INTERNATIONAL	1407.5	-3	2774.2	-7	-11.4	NM	-48.4	NM	NM	1.1	-0.2	NM	-0.07
PEAKE	264.3	-4	558.8	1	37.1	851	33.6	185	14.0	1.4	10.5	14	2.19
SOLIDATED PAPERS	393.0	5	772.8	-3	30.4	-38	58.4	-43	7.7	13.0	10.5	19	3.04
HOWARD	411.4	2	812.2	3	58.9	62	108.6	72	14.3	9.0	NM	18	2.90
NATIONAL PAPER	5000.0	-2	9900.0	0	-419.0	NM	-385.0	NM	NM	1.9	-3.0	NM	-0.93
S RIVER CORP. OF VIRGINIA	1412.4	-10	2794.3	-11	90.8	198	138.3	171	6.4	1.9	13.1	19	2.05
S MANVILLE	428.0	12	807.0	14	37.2	32	64.7	-59	8.7	7.4	16.5	21	0.61
ERLY-CLARK	3124.3	-7	6361.9	-3	350.8	-4	715.0	5	11.2	10.9	32.5	20	2.57
J	1322.3	5	2458.0	6	47.8	-29	68.0	-31	3.6	5.3	7.0	23	3.01
ATCH	394.2	2	793.7	2	9.9	-46	16.2	-30	2.5	4.7	5.8	25	1.89
N CAMP	1105.6	18	2162.7	13	10.6	-42	20.2	-74	1.0	1.9	1.4	NM	0.41
IVACO (2)	724.6	-5	1460.9	-3	37.9	-25	73.5	-35	5.2	6.7	7.7	19	1.70
ERHAEUSER	2909.0	1	5517.0	0	109.0	6	130.0	-47	3.7	3.6	7.7	34	1.76

PUBLISHING & BROADCASTING													
JSTRY COMPOSITE	14199.8	17	27159.0	16	776.0	127	1141.7	NM	5.5	2.8	6.2	45	0.92
BROADCASTING													
UP COMPOSITE	2662.7	13	5070.8	12	122.9	NM	-19.5	NM	4.6	NM	0.0	NM	0.05
ORD ENTERTAINMENT	249.7	19	434.8	25	121.9	322	130.5	57	48.8	13.8	34.8	13	1.83
TINGHOUSE ELECTRIC	2413.0	12	4636.0	11	1.0	NM	-150.0	NM	0.0	NM	-3.1	NM	-0.27
PUBLISHING													
UP COMPOSITE	11537.1	18	22088.2	17	653.1	62	1161.2	125	5.7	4.1	7.5	39	1.20
JONES	640.7	2	1246.7	3	34.9	-33	60.3	-33	5.4	8.3	9.7	26	1.67
NETT	1187.8	7	2264.6	6	194.7	42	329.8	47	16.4	12.4	23.8	20	5.17
COMMUNICATIONS	368.8	10	721.1	11	3.8	NM	-8.8	NM	1.0	NM	-25.5	NM	-0.13
HT-RIDDER	717.9	20	1324.3	13	61.3	47	236.8	267	8.5	7.0	34.7	11	4.52



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peaches in spring. It's
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CORPORATE SCOREBOARD

COMPANY	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY 12 MONTHS ENDING 6-30	PRICE- EARNINGS RATIO 7-25	MO EARN P SH
	2ND QUARTER 1997 \$ MIL	CHANGE FROM 1996 %	6 MONTHS 1997 \$ MIL	CHANGE FROM 1996 %	2ND QUARTER 1997 \$ MIL	CHANGE FROM 1996 %	6 MONTHS 1997 \$ MIL	CHANGE FROM 1996 %	2ND QUARTER 1997 %	2ND QUARTER 1996 %			
McGraw-Hill	836.7	18	1489.6	15	65.2	14	80.1	9	7.8	8.0	36.9	14	5
New York Times	721.9	11	1414.4	11	84.9	81	136.8	72	11.8	7.2	8.7	36	1
Scholastic (7)	254.8	-10	465.5	-7	-11.6	NM	-24.1	NM	NM	0.6	0.1	NM	0
Scripps (E. W.)	305.5	10	596.2	12	38.6	33	68.6	41	12.6	10.5	15.4	22	1
Time Warner	3193.0	49	6227.0	48	30.0	NM	82.0	NM	0.9	NM	-2.8	NM	-0
Times Mirror	811.8	-3	1585.7	-4	66.0	43	111.2	54	8.1	5.5	26.8	27	2
Tribune	719.7	12	1313.7	11	110.9	32	175.4	30	15.4	13.1	21.2	21	2
U S West Media Group	1277.0	13	2484.0	13	-97.0	NM	-206.0	NM	NM	NM	-4.1	NM	-0
Washington Post	501.4	6	955.5	7	71.4	13	119.1	19	14.2	13.4	18.3	20	21

21 SERVICE INDUSTRIES

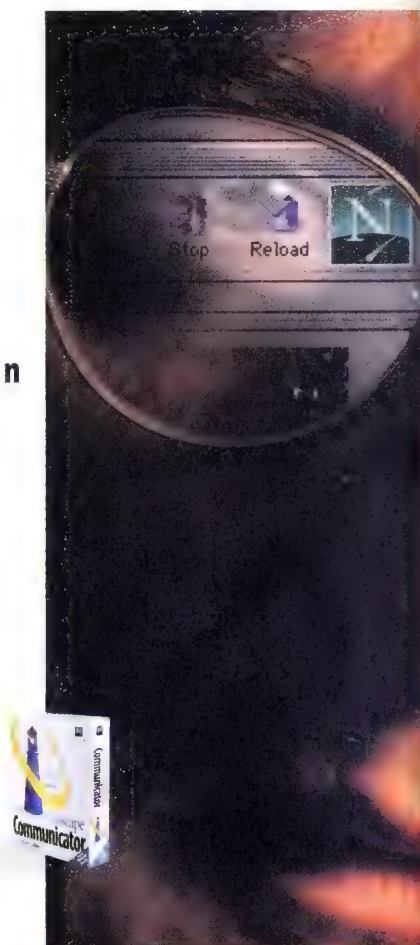
INDUSTRY COMPOSITE	44436.2	17	89722.7	20	804.1	-46	2374.1	-4	1.8	3.9	10.5	33	1.0
(A) CONSTRUCTION & ENGINEERING													
GROUP COMPOSITE	6201.7	21	12553.0	26	-32.5	NM	90.9	-63	NM	2.5	8.1	34	1.0
Apoee Enterprises (10)	244.8	7	485.0	9	6.8	36	12.4	46	2.8	2.2	16.0	21	1.0
Butler Mfg.	241.1	25	429.2	16	19.0	227	20.9	130	7.9	3.0	24.9	7	4.0
EG&G	368.7	4	715.7	2	-13.4	NM	-3.8	NM	NM	4.0	7.0	40	0.0
Fluor (2)	3185.8	23	6619.9	33	-70.1	NM	-8.1	NM	NM	2.5	8.5	37	1.0
Foster Wheeler	1030.6	6	1995.7	10	-3.6	NM	16.6	-66	NM	2.6	7.4	35	1.0
Jacobs Engineering Group (3)	430.2	-2	867.9	-6	12.0	15	23.4	15	2.8	2.4	14.8	17	1.0
Morrison Knudsen (1)	414.2**	401	803.8	455	7.4	360	14.4	NM	1.8	2.0	2.7	NM	-0.0
Stone & Webster	286.3	7	635.8	11	9.5	154	15.1	62	3.3	1.4	-3.6	NM	-0.0
(B) INDUSTRIAL DISTRIBUTION													
GROUP COMPOSITE	20779.1	19	43618.2	23	53.9	-89	650.1	-44	0.3	2.9	7.0	38	0.0
Airgas (9)	331.4	21	640.3	25	12.2	10	2.1	-91	3.7	4.1	7.2	53	0.0
Allegiance	1075.0	-1	2130.9	-3	22.0	86	43.0	60	2.0	1.1	-53.1	NM	-9.0
Arrow Electronics	1848.7	15	3704.1	12	51.8	-4	102.1	-8	2.8	3.4	14.2	15	3.0
Avnet (6)	1398.6	5	2777.1	2	47.4	-2	94.8	-2	3.4	3.6	12.2	16	4.0

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CORPORATE SCOREBOARD

COMPANY	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY 12 MONTHS ENDING 6-30	PRICE- EARNINGS RATIO 7-25	12 MONTHS EARNINGS PER SHARE
	2ND QUARTER 1997 \$ MIL	CHANGE FROM 1996 %	6 MONTHS 1997 \$ MIL	CHANGE FROM 1996 %	2ND QUARTER 1997 \$ MIL	CHANGE FROM 1996 %	6 MONTHS 1997 \$ MIL	CHANGE FROM 1996 %	2ND QUARTER 1997 %	2ND QUARTER 1996 %			
CASCADE OFFICE PRODUCTS	600.5	30	1198.3	30	11.7	-14	26.6	-9	2.0	3.0	12.5	24	0.84
OFFICE PRODUCTS INTERNATIONAL	390.7	15	792.3	16	5.0	27	9.4	17	1.3	1.2	6.0	18	0.48
PARSONS (1)	377.6	67	634.2	47	14.2	NM	20.2	NM	3.8	NM	12.6	55	0.55
PERKINS (11)	518.8	11	986.1	9	29.2	32	51.9	29	5.6	4.7	21.9	20	2.25
PLANT	3240.0	9	8584.0	43	-420.0	NM	-198.0	NM	NM	4.0	1.1	NM	0.17
PLANT PARTS	1510.5	5	2968.1	4	83.7	4	160.3	4	5.5	5.6	19.1	18	1.86
PLANT (W. W.)	1051.2	18	2036.8	18	57.6	16	112.2	13	5.5	5.6	15.7	23	4.26
PLANT SUPPLY (11)	421.4	21	786.8	20	7.8	41	15.2	43	1.8	1.6	12.1	13	2.07
PLANT	250.2**	2	502.4	3	6.7	24	2.3	-78	2.7	2.2	6.8	27	0.61
PLANT INDUSTRIES (7)	325.0	6	629.0	6	11.7	-2	21.5	-11	-3.6	3.9	11.8	18	2.32
PLANT	2684.3	131	5956.4	112	32.1	132	36.7	-17	1.2	1.2	10.1	24	0.66
PLANT STANDARD ELECTRONICS (9)	396.3	6	787.7	4	7.3	19	14.3	3	1.8	1.6	11.0	14	1.01
PLANT STEEL & ALUMINUM	243.8	48	445.4	38	8.4	8	15.3	-2	3.4	4.7	14.8	15	1.90
PLANT	348.2	19	666.8	20	9.1	20	15.9	21	2.6	2.6	14.9	15	1.23
PLANT TOLL	730.0	20	1390.6	13	19.1	1	35.6	-14	2.6	3.1	15.1	11	1.47
PLANT WORLDWIDE (3)	1764.0	1	3479.9	0	12.5	NM	23.1	2	0.7	NM	5.7	23	0.81
PLANT STATIONERS	610.0	14	1245.1	11	9.9	87	19.9	47	1.6	1.0	41.7	12	2.49
PLANT SCIENTIFIC PRODUCTS	310.5	11	601.3	8	6.1	98	9.6	86	2.0	1.1	6.1	34	0.52
PLANT ELECTRONICS	352.4	15	674.5	7	8.4	-24	16.2	-27	2.4	3.6	15.1	19	2.69
POLLUTION CONTROL													
PLANT COMPOSITE	2568.9	-4	5033.1	-2	180.0	-18	358.5	-11	7.0	8.2	8.7	35	0.86
PLANT INTERNATIONAL	241.6**	-27	507.5	-21	0.0	NM	0.1	-98	0.0	0.5	5.3	34	0.08
PLANT MANAGEMENT	2327.3	0	4525.6	1	180.0	-17	358.4	-10	7.7	9.3	8.7	35	0.90
PRINTING & ADVERTISING													
PLANT COMPOSITE	3954.9	6	7539.4	6	220.3	5	326.0	NM	5.6	5.6	19.8	24	1.72
PLANT (3)	258.2	5	500.7	5	9.4	115	12.0	NM	3.7	1.8	NM	17	1.03
PLANT A	276.2	7	551.6	4	12.6	6	22.6	9	4.6	4.6	13.3	17	1.72
PLANT LOWER PRESS HOLDINGS	316.8	5	614.3	16	4.4	72	6.1	NM	1.4	0.8	4.9	93	0.23

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CORPORATE SCOREBOARD

COMPANY	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY 12 MONTHS ENDING 6-30	PRICE-EARNINGS RATIO 7-25	MON. EARN. PER SHARE
	2ND QUARTER 1997 \$ MIL.	CHANGE FROM 1996 %	6 MONTHS 1997 \$ MIL.	CHANGE FROM 1996 %	2ND QUARTER 1997 \$ MIL.	CHANGE FROM 1996 %	6 MONTHS 1997 \$ MIL.	CHANGE FROM 1996 %	2ND QUARTER 1997 %	2ND QUARTER 1996 %			
DONNELLEY (R. R.) & SONS	1505.0	-4	2980.2	-4	37.7	-31	67.0	NM	2.5	3.5	14.1	26	1.1
INTERPUBLIC GROUP	812.3**	20	1409.6	19	89.8	8	111.8	11	11.1	12.3	25.9	23	1.7
OMNICOM GROUP	786.3	18	1482.9	18	66.4	25	106.5	27	8.4	7.9	25.1	26	2.0
(E) OTHER SERVICES													
GROUP COMPOSITE	10931.6	23	20979.1	23	382.5	-12	948.7	20	3.5	4.9	13.9	33	1.0
ABM INDUSTRIES (2)	294.3**	12	585.9	13	5.8	24	10.7	22	2.0	1.8	12.8	20	1.1
ACCUSTAFF	543.5	58	1020.7	64	23.7	127	45.1	151	4.4	3.0	8.7	49	0.8
ACNIELSEN	356.3	6	681.1	6	10.2	498	6.1	NM	2.9	0.5	8.7	29	0.7
ADMINISTAFF	274.8	31	537.0	33	0.9	69	0.9	NM	0.3	0.3	6.9	71	0.3
CDI	378.1	12	738.6	10	11.9	26	22.7	27	3.2	2.8	23.4	18	2.1
COGNIZANT	464.6	12	899.3	14	60.1	17	113.0	23	12.9	12.3	31.8	34	1.2
CORESTAFF	241.4	80	458.3	93	7.4	83	13.2	96	3.1	3.0	9.7	38	0.7
CUC INTERNATIONAL (11)	624.7	21	1298.9	22	70.5	35	160.0	36	11.3	10.1	13.6	51	0.4
HANDLEMAN (8)	278.4	7	608.9	0	0.2	NM	6.7	NM	0.1	NM	1.9	39	0.1
HFS	579.6**	68	1099.6	77	106.4	NM	-15.3	NM	NM	17.3	2.6	80	0.7
KELLY SERVICES	959.7	19	1840.6	20	19.4	11	33.7	11	2.0	2.2	14.7	16	2.0
MANPOWER	1792.2	23	3313.2	20	40.9	6	67.5	9	2.3	2.6	28.9	24	2.0
NORRELL (2)	317.9	27	599.2	25	8.5	36	15.7	38	2.7	2.5	25.1	28	1.1
OLSTEN	1014.4**	26	1965.2	25	25.3	-15	44.5	-13	2.5	3.7	6.1	31	0.6
PITTSTON BRINK'S GROUP	268.8	21	520.2	20	17.7	26	33.0	28	6.6	6.3	19.6	19	1.7
ROBERT HALF INTERNATIONAL	311.6	48	594.6	46	22.2	56	42.1	53	7.1	6.8	22.8	43	1.2
SERVICE CORP. INTERNATIONAL	601.1	6	1239.6	9	78.8	27	209.9	57	13.1	11.0	14.8	24	1.4
SERVICEMASTER	1010.8	10	1827.9	10	75.7	6	122.6	10	7.5	7.8	26.3	19	1.2
VOLT INFORMATION SCIENCES (2)	345.7	37	634.5	33	7.1	42	12.2	67	2.1	2.0	18.7	29	1.8
WACKENHUT	273.6	23	515.7	18	2.5	32	4.5	57	0.9	0.9	7.1	29	0.7

22 TELECOMMUNICATIONS

INDUSTRY COMPOSITE	65328.3	8	128179.9	8	4728.9	-24	10749.7	-15	7.2	10.3	17.9	22	2.0
(A) EQUIPMENT & SERVICES													
GROUP COMPOSITE	33029.7	11	64333.1	11	2122.0	-4	4186.1	-6	6.4	7.4	10.9	33	1.2
ADC TELECOMMUNICATIONS (2)	279.2	45	536.0	51	28.9	45	39.3	8	10.3	10.3	13.7	58	0.7
AIRTOUCH COMMUNICATIONS †	901.0	87	1737.0	87	119.0	95	196.0	73	13.2	12.7	5.8	69	0.4
AT&T	13173.0	2	26221.0	2	959.0	-38	2081.0	31	7.3	12.0	22.4	12	2.8
DSC COMMUNICATIONS	382.9	7	729.1	10	41.8	97	58.2	77	10.9	6.0	1.5	NM	0.1
EXCEL COMMUNICATIONS	330.6	-4	661.9	6	37.0	-4	72.1	0	11.2	11.1	47.7	18	1.3
LCI INTERNATIONAL	338.4	26	653.1	26	21.4	21	41.9	27	6.3	6.6	18.3	21	0.9
LUCENT TECHNOLOGIES (3)	6340.0	18	11489.0	16	213.0	196	279.0	NM	3.4	1.3	38.8	39	2.1
MCI COMMUNICATIONS	4843.0	6	9726.0	7	280.0	-7	575.0	-3	5.8	6.6	10.4	20	1.7
SPRINT	3678.6	6	7267.6	7	255.9	-19	545.9	-13	7.0	9.1	12.7	19	2.5
TELEPHONE & DATA SYSTEMS †	360.0	23	678.2	23	6.8	89	16.4	-82	1.9	20.3	2.4	47	0.8
TELLABS	292.7	54	539.8	49	58.8	NM	121.8	879	20.1	NM	29.0	50	1.2
360 COMMUNICATIONS †	340.3	24	647.1	26	21.8	-10	31.3	0	6.4	8.9	12.5	37	0.4
WORLDCOM	1770.1	65	3447.3	64	78.6	NM	128.3	NM	4.4	NM	-14.7	NM	-4.9

(B) TELEPHONE COMPANIES

GROUP COMPOSITE	32298.6	5	63846.9	5	2606.9	-36	6563.6	-19	8.1	13.1	25.9	17	2.9
ALLTEL	816.9	2	1601.2	1	173.9	89	275.6	57	21.3	11.4	17.6	15	2.0
AMERITECH	3986.0	6	7845.0	7	537.0	-5	1073.0	3	13.5	15.1	26.9	17	3.9
BELL ATLANTIC	3440.7	7	6854.6	6	498.9	8	1014.5	9	14.5	14.4	23.5	17	4.2
BELLSOUTH	4851.0	5	9696.0	6	654.0	4	1347.0	-16	13.5	13.6	18.7	18	2.6
CINCINNATI BELL	433.1	15	862.6	17	54.2	21	111.4	29	12.5	11.9	30.5	20	1.5
FRONTIER	584.7	-13	1158.1	-13	42.4	-39	28.9	-79	7.3	10.3	11.3	29	0.6
GTE	5692.0	8	10973.0	7	671.0	5	1336.0	6	11.8	12.1	39.8	15	2.9
NYNEX	3513.6	2	6815.1	2	380.5	6	540.1	-6	10.8	10.4	19.1	18	2.9
SBC COMMUNICATIONS	5936.0	3	11927.0	5	-787.0	NM	70.0	-96	NM	14.0	34.7	NA	NA
SOUTHERN NEW ENGLAND TELECOMMS.	501.6**	3	984.3	2	50.0	-1	96.1	-6	10.0	10.4	38.3	14	2.8
U S WEST COMMUNICATIONS GROUP	2543.0	2	5130.0	3	332.0	2	671.0	9	13.1	13.0	30.6	14	2.6

23 TRANSPORTATION

INDUSTRY COMPOSITE	47420.9	9	91818.7	10	2875.0	10	4495.4	32	6.1	6.0	16.9	15	3.8
(A) AIRLINES													
GROUP COMPOSITE	21058.9	4	40930.1	7	1453.4	5	2249.8	58	6.9	6.9	30.8	9	5.6
ALASKA AIR GROUP	435.0	4	819.4	6	20.8	16	15.1	40	4.8	4.3	14.6	10	2.9
AMERICA WEST HOLDINGS	477.8	3	939.9	7	23.0	-22	37.0	-15	4.8	6.4	0.5	86	0.1
AMR	4710.0	4	9136.0	3	302.0	3	454.0	1	6.4	6.4	19.0	8	12.1
CONTINENTAL AIRLINES	1786.0	4	3484.0	11	128.0	-23	202.0	21	7.2	10.2	40.5	9	4.1
DELTA AIR LINES (6)	3541.0	5	6961.0	10	302.0	86	491.0	NM	8.5	4.8	28.2	8	11.3
NORTHWEST AIRLINES	2557.6	1	4933.1	3	136.2	-33	200.8	-22	5.3	8.0	148.3	7	5.1
SOUTHWEST AIRLINES	956.9	5	1844.0	10	93.8	10	144.7	22	9.8	9.4	13.8	18	1.5
UAL	4382.0	5	8503.0	8	242.0	7	347.0	50	5.5	5.4	52.4	11	6.8
US AIRWAYS GROUP	2212.6	3	4313.7	7	205.6	2	358.2	113	9.3	9.3	NM	7	5.2

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CORPORATE SCOREBOARD

COMPANY	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY 12 MONTHS ENDING 6-30	PRICE-EARNINGS RATIO 7-25	MOI EAP F SH
	2ND QUARTER 1997 \$ MIL	CHANGE FROM 1996	6 MONTHS 1997 \$ MIL	CHANGE FROM 1996	2ND QUARTER 1997 \$ MIL	CHANGE FROM 1996	6 MONTHS 1997 \$ MIL	CHANGE FROM 1996	2ND QUARTER 1997 %	2ND QUARTER 1996 %			
(B) RAILROADS													
GROUP COMPOSITE	8938.0	12	17600.7	12	868.1	5	1424.9	-1	9.7	10.4	13.1	18	4.
BURLINGTON NORTHERN SANTA FE	2073.0	2	4109.0	1	235.0	11	385.0	-3	11.3	10.4	14.3	17	5.
CSX	2678.0	0	5245.0	1	227.0	-3	378.0	-1	8.5	8.8	16.1	15	3.
NORFOLK SOUTHERN	1304.0**	2	2553.7	2	190.1	-5	317.9	-14	14.6	15.6	14.3	19	5.
UNION PACIFIC	2883.0	43	5693.0	43	216.0	16	344.0	17	7.5	9.2	9.5	21	3.
(C) TRANSPORTATION SERVICES													
GROUP COMPOSITE	12337.0	18	23229.6	17	457.7	32	734.5	44	3.7	3.3	13.8	22	2.
AIR EXPRESS INTERNATIONAL	386.6	21	737.7	20	13.0	34	21.6	36	3.4	3.0	16.6	24	1.
AIRBORNE FREIGHT	712.8	15	1368.3	12	28.3	165	42.7	255	4.0	1.7	13.0	17	2.
BUDGET GROUP	306.3	22	408.8	156	2.7	18	3.5	-1	0.9	2.4	4.8	NM	0.
CNF TRANSPORTATION	1002.6	12	1945.2	12	30.0	27	51.9	39	3.0	2.7	19.0	18	1.
FEDERAL EXPRESS (7)	3068.3	12	5975.1	13	132.6	15	195.6	37	4.3	4.2	12.8	20	3.
GATX	434.7**	29	829.3	29	30.2	18	61.4	22	6.9	7.6	12.8	13	4.
HERTZ	976.3	7	1854.7	8	53.9	36	73.6	52	5.5	4.3	103.9	NA	
HUB GROUP	268.2	28	519.3	101	2.2	33	4.2	65	0.8	0.8	18.1	23	1.
NEWPORT NEWS SHIPBUILDING	450.0	-6	853.0	-7	14.0	-22	27.0	-27	3.1	3.8	18.0	NA	
PITTSBURGH BURLINGTON GROUP	400.4	11	772.5	9	-1.9	NM	3.2	-75	NM	2.4	8.0	19	1.
REPUBLIC INDUSTRIES	2377.6	58	4147.7	50	69.5	132	102.3	115	2.9	2.0	NA	NA	
RYDER SYSTEM	1393.1	-2	2729.0	-1	50.0	58	83.7	100	3.6	2.2	1.0	NM	0.
TRINITY INDUSTRIES (9)	560.1	-3	1089.0	-7	33.2	9	63.8	10	5.9	5.3	14.0	14	2.
(D) TRUCKING & SHIPPING													
GROUP COMPOSITE	5087.0	5	10058.4	6	95.8	91	86.3	116	1.9	1.0	-0.4	NM	-0.0
ALEXANDER & BALDWIN	317.9**	3	614.2	8	18.3	3	39.5	58	5.8	5.8	11.6	15	1.
APL	626.6**	-2	1305.5	-5	7.4	-65	-2.4	NM	1.2	3.3	8.5	19	1.0
ARKANSAS BEST	435.8	5	842.5	3	5.0	NM	4.7	NM	1.2	NM	-13.1	NM	-0.9
CALIBER SYSTEM	574.7	-7	1215.9	2	13.6	NM	-35.6	NM	2.4	0.0	-43.8	NM	-5.
CONSOLIDATED FREIGHTWAYS	578.6	9	1124.3	9	6.9	NM	10.2	NM	1.2	NM	-8.1	NM	-0.
HUNT (J.B.) TRANSPORT SERVICES	385.2	3	750.6	3	1.9	-73	2.4	-75	0.5	1.8	4.3	38	0.4
LANDSTAR SYSTEM	333.7	1	639.2	2	6.4	-8	9.4	-7	1.9	2.1	12.4	17	1.4
ROADWAY EXPRESS	609.4	14	1200.0	14	7.8	92	13.3	99	1.3	0.8	12.7	16	1.3
USFREIGHTWAYS	380.8	15	736.6	14	14.5	79	24.3	95	3.8	2.5	12.5	17	1.8
YELLOW	844.4	11	1629.6	9	14.0	592	20.5	NM	1.7	0.3	1.4	NM	0.2
24 UTILITIES & POWER													
INDUSTRY COMPOSITE	54101.6	11	116572.8	13	3735.5	-9	8971.3	-6	6.9	8.4	10.7	14	2.0
(A) ELECTRIC, WATER & COGENERATION													
GROUP COMPOSITE	46602.4	10	97127.3	10	3331.8	-12	7662.1	-9	7.2	8.9	10.5	14	1.9
AES †	261.0	50	522.0	51	42.0	50	82.0	44	16.1	16.1	16.8	42	1.8
ALLEGHENY POWER SYSTEM	542.8	-1	1157.7	-3	54.0	-4	133.9	22	9.9	10.2	10.6	15	1.9
AMERICAN ELECTRIC POWER	1382.2	-1	2874.2	-2	123.3	0	306.0	-3	8.9	8.8	12.7	14	3.1
AMERICAN WATER WORKS	237.9	4	451.3	6	31.6	19	49.7	14	13.3	11.6	9.7	16	1.3
BALTIMORE GAS & ELECTRIC	746.4	2	1634.1	3	15.0	-77	87.1	-47	2.0	8.8	7.0	20	1.3
BOSTON EDISON	426.7	9	849.5	9	34.0	22	54.9	3	8.0	7.2	12.5	10	2.6
CALENERGY	525.0**	353	1091.0	429	30.9	60	58.3	73	5.9	16.6	13.4	21	1.8
CAROLINA POWER & LIGHT	666.0	-3	1382.1	-6	54.3	-13	136.6	-25	8.2	9.1	12.5	15	2.3
CENTERIOR ENERGY	612.6	1	1224.2	1	27.7	-16	57.4	7	4.5	5.4	6.5	13	0.8
CENTRAL & SOUTH WEST	1184.0	-7	2462.0	-1	76.0	347	105.0	64	6.4	1.3	9.5	12	1.6
CINERGY	865.3	21	1895.5	18	58.7	-6	176.1	-2	6.8	8.8	12.9	16	2.1
CMS ENERGY	1040.0	11	2353.0	6	62.7	5	155.7	0	6.0	6.4	13.5	15	2.3
CONSOLIDATED EDISON CO. OF N.Y.	1504.0	-2	3390.2	-1	47.6	-33	214.2	-13	3.2	4.6	11.2	11	2.7
DOMINION RESOURCES	1634.6	46	3489.8	48	89.7	-14	270.2	2	5.5	9.3	9.5	14	2.6
DPL	272.6	-4	632.8	-4	35.2	0	101.7	3	12.9	12.3	14.2	14	1.7
DQE	284.0	-3	586.1	-1	46.8	20	91.9	13	16.5	13.3	13.5	13	2.4
DTE ENERGY	892.3	2	1760.9	-1	87.8	8	161.7	-18	9.8	9.3	8.1	15	1.9
DUKE ENERGY	3112.8	22	6898.6	27	168.6	-29	480.3	-9	5.4	9.3	13.8	16	3.0
EDISON INTERNATIONAL	2167.2	19	4167.9	10	150.9	-10	307.6	-11	7.0	9.2	10.9	16	1.6
ENOVA	501.5	6	1009.4	8	58.0	18	108.5	-7	11.6	10.4	14.8	12	1.9
FLORIDA PROGRESS	797.3	3	1544.8	3	-37.8	NM	4.6	-96	NM	7.9	7.7	21	1.5
FPL GROUP	1587.1	8	3032.3	7	170.1	9	276.9	8	10.7	10.6	13.1	14	3.4
GPU	927.3	2	1969.3	2	80.6	-5	246.3	21	8.7	9.3	10.7	12	2.8
HAWAIIAN ELECTRIC INDUSTRIES	360.3	4	719.4	7	24.5	6	47.0	8	6.8	6.6	10.0	15	2.5
HOUSTON INDUSTRIES	1064.4	-4	1942.5	0	128.1	-15	194.4	38	12.0	13.5	12.0	11	1.9
ILLINOVA	542.9	45	1113.3	35	36.8	-13	86.3	-5	6.8	11.4	11.2	9	2.4
LG&E ENERGY	747.3	-2	2050.5	25	22.8	-9	45.1	-15	3.0	3.3	11.8	15	1.4
MIDAMERICAN ENERGY HOLDINGS	390.6	0	975.0	8	28.9	6	67.9	-13	7.4	7.0	10.5	13	1.2
NEW ENGLAND ELECTRIC SYSTEM	577.6	5	1215.8	7	34.1	-8	97.7	-3	5.9	6.7	12.1	11	3.1
NEW YORK STATE ELECTRIC & GAS	470.4	3	1058.5	-2	26.3	26	108.3	-9	5.6	4.6	8.7	11	2.2
NIAGARA MOHAWK POWER	945.7	-2	2109.5	-1	40.7	-23	143.8	-4	4.3	5.5	5.0	10	0.9
NIPSCO INDUSTRIES	523.4	31	1183.1	17	30.4	19	103.4	9	5.8	6.4	14.7	14	3.0
NORTHEAST UTILITIES	903.3	4	1878.7	-1	-56.5	NM	-31.1	NM	NM	2.3	-5.5	NM	-0.9
NORTHERN STATES POWER	594.3	0	1336.8	2	20.9	-52	89.3	-19	3.5	7.3	11.0	15	3.4
OGE ENERGY	333.2	-4	624.4	0	31.1	-12	30.8	-14	9.3	10.1	13.5	15	3.1
OHIO EDISON	593.3	-1	1198.0	-1	80.7	0	160.6	2	13.6	13.4	12.1	10	2.1
PACIFICORP	1220.1	42	2261.9	30	75.7	-7	178.4	-9	6.2	9.5	11.0	15	1.4

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CORPORATE SCOREBOARD

COMPANY	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY 12 MONTHS ENDING 6-30	PRICE-EARNINGS RATIO 7-25	MON. EARN. PER SHARE
	2ND QUARTER 1997 \$ MIL	CHANGE FROM 1996 %	6 MONTHS 1997 \$ MIL	CHANGE FROM 1996 %	2ND QUARTER 1997 \$ MIL	CHANGE FROM 1996 %	6 MONTHS 1997 \$ MIL	CHANGE FROM 1996 %	2ND QUARTER 1997 %	2ND QUARTER 1996 %			
PECO ENERGY	1032.3	4	2195.7	2	129.5	23	249.2	-5	12.5	10.7	10.4	10	2.7
PG&E	3082.9	44	6448.4	47	201.2	80	382.0	3	6.5	5.2	8.7	13	1.8
PINNACLE WEST CAPITAL	488.9	8	887.5	9	70.4	7	99.4	-5	14.4	14.5	10.5	13	2.3
POTOMAC ELECTRIC POWER	451.0	-10	840.0	-10	50.1	-31	73.1	-16	11.1	14.4	11.1	12	1.7
PP&L RESOURCES	686.0	3	1472.0	1	71.0	3	195.0	2	10.4	10.3	11.8	10	2.0
PUBLIC SERVICE CO. OF COLORADO	542.7	12	1220.3	10	30.6	-11	93.5	-6	5.6	7.1	11.7	15	2.6
PUBLIC SERVICE ENTERPRISE GROUP	1322.9	-1	3055.5	-3	108.7	-16	262.9	-20	8.2	9.7	9.6	12	2.1
SCANA	332.0	-5	717.1	-4	30.9	-22	89.6	-18	9.3	11.3	11.5	13	1.8
SOUTHERN	2717.0	6	5302.0	6	253.6	-18	479.2	-15	9.3	12.1	10.9	14	1.4
TECO ENERGY	463.6	6	917.2	5	50.7	0	101.7	0	10.9	11.7	16.0	15	1.6
TEXAS UTILITIES	1588.5	6	3082.3	-2	188.1	-16	330.2	-12	11.8	13.3	11.6	11	3.1
UNICOM	1651.3	7	3401.6	5	5.3	-96	138.6	-50	0.3	7.8	8.7	9	2.4
UNION ELECTRIC	550.0	1	1037.2	0	69.6	9	101.3	-3	12.7	11.7	12.6	13	2.8
WHEELABRATOR TECHNOLOGIES	256.1	5	504.2	9	39.9	-15	78.2	-8	15.6	19.3	-0.7	NM	-0.0
(B) GAS, OIL & TRANSMISSION													
GROUP COMPOSITE	7499.2	22	19445.5	28	403.7	28	1309.2	18	5.4	5.1	12.2	17	2.5
BROOKLYN UNION GAS (3)	247.0	-3	836.3	-2	2.3	NM	82.6	18	0.9	NM	13.6	11	2.7
COLUMBIA GAS SYSTEM	810.7	39	2338.4	31	34.9	326	197.6	24	4.3	1.4	15.2	15	4.7
CONSOLIDATED NATURAL GAS	1030.9	57	2729.5	39	39.0	13	210.5	-2	3.8	5.3	12.6	19	3.1
EL PASO NATURAL GAS	979.0	67	2810.0	136	50.0	105	103.0	NM	5.1	4.2	7.6	20	2.9
EQUITABLE RESOURCES	400.8	2	953.3	-8	-9.3	NM	18.5	-53	NM	0.2	5.1	28	1.0
K N ENERGY	357.8	29	847.3	28	10.9	23	31.2	19	3.0	3.2	12.8	18	2.2
MCN ENERGY GROUP	387.9	9	1176.7	3	13.3	76	99.3	12	3.4	2.1	14.0	18	1.7
NICOR	303.7	-10	1203.7	16	28.8	13	69.2	-2	9.5	7.5	16.2	15	2.4
PACIFIC ENTERPRISES	592.0	6	1386.0	16	59.0	2	111.0	-1	10.0	10.4	14.8	13	2.4
PIEDMONT NATURAL GAS (2)	259.3	0	571.8	15	32.3	-1	69.6	5	12.4	12.5	11.6	14	1.7
SONAT	841.5	-1	1963.8	24	36.2	-11	103.1	20	4.3	4.8	13.6	19	2.5
USX-DELHI GROUP	268.0	23	606.7	23	-1.5	NM	-0.1	NM	NM	NM	4.4	24	0.5
WILLIAMS	1020.6	22	2022.0	17	107.8	34	213.7	15	10.6	9.6	11.3	20	2.3

ALPHABETICAL LIST OF COMPANIES

The number following each company name identifies the Scoreboard category under which it is listed

A	Abril 10c Abbott Laboratories 12d ARM Industries 21e AccuStaff 21e ACNielsen 21e Adaptec 9d ADC Telecomm 22a Advanced Micro 9d ADVO 21d Aeroquip-Vickers 15a AES 24a AFLAC 17b AGCO 15c Ahmanson (H.F.) 17c Air Express Intl 23c Air Products & Chemicals 4 Airborne Freight 23c 21b AirTouch Communications 22a AK Steel Holding 16b Alaska Air Group 23a Alcoa 6d Albertson's 10c Alex Brown 17a Alexander & Baldwin 23d Affinity 17a Allegheny Power 24a Allegheny Teledyne 5 Allegiance 21b Allergan 12b AlliedSignal 5 Allstate 17b Alltel 22b Alumax 16a Alroa 16a Amerada Hess 11a America West Holdings 23a American Electric 24a American Express 17a American Financial Group 17b American General 17b American Greetings 14c American Home 12b American Intl Group 17b American National 17b	American Standard 13a American States Financial 17b American Stores 10c American Water Works 24a AmeriSource Health 12a Ameritech 22b Ames Dept. Stores 8 Amgen 12b Amoco 11a AMP 9d AMR 23a Analog Devices 9d Anheuser-Busch 6c Anixter International 5 Apache 11a APL 23d Apogee Enterprises 21a Apple Computer 18b Applied Materials 15c Apria Healthcare Group 12c Arbor Drugs 12a Arco Chemical 4 Arkansas Best 23d Armco 16b Armstrong World 6b Arrow Electronics 21b Arvin Industries 2b Asarco 16c Ascend Communications 18c Ashland 11a Associates First Capital 17a AT&T 22a Atlantic Richfield 11a AutoZone 8 Avery Dennison 15a Avnet 21b Avon Products 6d AVX 9d	B Baker Hughes 11b Ball 7a Baltimore G&E 24a Banc One 3b Bank of New York 3a BankAmerica 3d BankBoston 3a Bankers Trust 3a Banta 21d Bard (C.R.) 12d Barnes & Noble 8 Barnett Banks 3c Bausch & Lomb 12d Baxter International 12d Bay Networks 18c BB&T 3c BDM International 18c Bear Stearns 17a Beckman Instruments 9c Becton, Dickinson 12d Bell Atlantic 22b BellSouth 22b Bemis 7b Bergens Brunswick 12a Best Buy 6b Bethlehem Steel 16b Beverly Enterprises 12c Big Flower Press 21d Bindley Western Inds 12a BJ Services 11b BJ's Wholesale Club 8 Black & Decker 15b Block (H&R) 17a Boeing 1 Boise Cascade 19a Boise Cascade Office Prods 21b Borders Group 8 Borg-Warner Automotive 2b Boston Edison 24a Boston Scientific 12d Bowater 19b Bradleys 8 Brinker International 14a Bristol-Myers Squibb 12b Brooklyn Union Gas 24b Brown Group 6a Brown-Forman 6c Bruno's 10c Brunswick 14c Brylcre 8 BT Office Products 21b Budget Group 23c Burlington Industries 15d	C Burlington Northern Santa Fe 23b Burlington Resources 11a Butler Mfg 21a Cabletron Systems 18c Cabot 4 Caldor 8 CalEnergy 24a Caliber System 23d Callaway Golf 14c Campbell Soup 10b Canandaigua Wine 6c Capital One Financial 17a Cardinal Health 12a Carlisle 15a Carnival 14c Carolina Power 24a Carpenter Tech 16b Carson Pine Scott 8 Case 15c Casey's General Stores 10c Caterpillar 15c CU 21e CellStar 21b Centenior Energy 24a Centex 13b Central & South West 24a Ceridian 18c Champion Enterprises 13b Champion Intl 19b Charter One Financial 17c Chase Manhattan 3a Chesapeake 19b Chevron 11a Chiquita Brands Intl 10b Chiron 12b Chrysler 2a CHS Electronics 18c Cigna 17b Cincinnati Bell 22b Cincinnati Financial 17b Cincinnati Milacron 15b CINergy 24a Circuit City Stores 6b Circus Circus 14b Cisco Systems 18c	Citicorp 3a Clorox 6d CMS Energy 24a CNF Transportation 23c Coastal 11a Coca-Cola 6c Coca-Cola Enterprises 6c Cognizant 21e Cole National 8 Colgate-Palmolive 6d Collins & Aikman 15d Coltec Industries 15a Columbia Gas 24b Columbia/HCA Healthcare 12c Comdisco 18c Comerica 3b Commercial Metals 16b Commonwealth Inds 16c Compaq Computer 18b CompuCom Systems 18a Computer Associates 18c Computer Sciences 18c ConAgra 10b Conseco 17b Consolidated Edison 24a Cons. Freightways 23d Cons. Natural Gas 24b Consolidated Papers 19b Consolidated Stores 8 Continental Airlines 23a Cooper Cameron 11b Cooper Industries 9a Cooper Tire & Rubber 2c Coors (Adolph) 6c COREStaff 21e Corning 15a Corporate Express 8 Costco 8 Countrywide Credit 17a Coventry 12c CPC International 10b Cracker Barrel 14a Crane 21b Crestar Financial 3c Crompton & Knowles 4 Crown Cork & Seal 7a	CSX 23b CUC International 21e Cummins Engine 2b CVS 12a Cyprus Ammax Minerals 16c Cytec Industries 4 D Dana 2b Danaher 15b Darden Restaurants 14a Dart Group 5 Data General 18b Dayton Hudson 8 Dean Foods 10b Deere 15c Dell Computer 18b Delta Air Lines 23a Deluxe 18a Detroit Diesel 2b Dexter 15d Dial 6d Diebold 18a Digital Equipment 18b Dillard's 8 Disney (Walt) 14c Dole Food 10b Dollar General 8 Dominick's Supermarkets 10c Dominion Resources 24a Donaldson, Lufkin & Jenrette 17a Donnelley (R.R.) 21d Dover 15c Dow Chemical 4 Dow Jones 20b DPL 24a DQE 24a Dresser Industries 15c Dreyer's Grand Ice Cream 10b DSC Communs 22a DTE Energy 24a DuPont 4 Duke Energy 24a Dun & Bradstreet 17a	E Eagle Food Centers 10c Earthgrains 10b Eastman Chemical 4 Eastman Kodak 14c Eaton 9a Echlin 2b Ecolab 6d Edison International 24a Edwards (A.G.) 17a EG&G 21a El Paso Natural Gas 24b EMC 18b Engelhard 4 Enova 24a Enron 21b Equifax 17a Equitable Resources 24b Essex Intl 16c Ethyl 4 Everest Reinsurance 17b Excel Communications 22a Excel Industries 2b Express Scripts 12c Exxon 11a F Family Dollar Stores 8 Fannie Mae 17a Federal Express 23c Federal Home Loan 17a Federal-Mogul 2b Federated Dept. Stores 8 Ferro 4 Fieldcrest Cannon 15d Fifth Third Bancorp 3b Fina 11a Fingerhut 8 Finnova Group 17a First American 3c First American Fml 17a First Bank System 3b First Chicago NBD 3b First Data 18c First of America Bank 3b First Security 3d First Tennessee Natl 3c
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ALPHABETICAL LIST OF COMPANIES

The number following each company name identifies the Scoreboard category under which it is listed

3c c ncial Group 3a Ents 13b 10a ogress 24a ndustries 10b 10c 8 r 2a rd 19b rands 6e eeler 21a cal Mgmt 12c p 24a Resources 17a McMoRan C&G 16c B 14 Brands 6b 20b 2000 18b 2b ent 20a Cable 16c Dynamics 1 Electric 5 Mills 10b Motors 2a Nutrition 10c Signal 9a Parts 21b Gulf 4 Pacific 19a od 10c 3d West 17c (B.F.) 4 r Tire & Rubber 2c a (V.R.) 15a (W.W.) 21b 4P 10c kes Chemical 4 ee Financial 17a ldings 18c 12d Mills 15d am Aerospace 1 ton 11b nan 21e (M.A.) 4 rd Brothers 10c t General 5 avidson 14c hfeiger 15c s Entertainment 14b 1b 16c 14c an Electric 24a Wheels Intl 2b outh 12c er 8 Meyers 6b + J 10b s 4 Foods 10b 3c -Packard 18b 15a e rand 15a ores 8 otels 14b Depot 8 ase 8 dustries 18a	Honeywell 9c Hormel Foods 10b Host Marriott 14b Host Marriott Services 14a Household Intl 17a Houston Industries 24a Hub Group 23c Hubbell 9a Hudson Foods 10b Hughes Electronics 9b Hughes Supply 21b Humana 12c Hunt (J.B.) 23d Huntington Bancshares 3b IBM 18b IBP 10b ICF Kaiser Intl 21c IKON Office Solutions 5 Illinois Tool Works 15a Illinova 24a Imation 14c IMC Global 4 InaCom 18c Ingersoll-Rand 15c Inland Steel 16b Integrated Health Svcs. 12c Intel 9d Intelligent Electronics 18a Interface 15d Intergraph 18c Interpublic Group 21d Interstate Bakeries 10b Intimate Brands 8 International Flavors 4 Intl. Multifoods 10a International Paper 19b Iomega 18b ITT Industries 5 Jablit Circuit 9d Jacobs Engineering 21a James River 13b Jefferson Smurfit 7b Johns Manville 19b Johnson & Johnson 12d Johnson Controls 15a Jones Apparel Group 6a K-III Communications 20b K N Energy 24b Kaiser Aluminum 16a Kaman 21b Kaufman & Broad 13b Kellwood 6a Kelly Services 21e Kennametal 15b Kerr-McGee 11a KeyCorp 3b Kimberly-Clark 19b KLA-Tencor 9c Kmart 8 Knight-Ridder 20b Kohl's 8 Kroger 10c La Z Boy 6b Laboratory Corp. of America 12c Lafarge 13a Lam Research 15c Lands' End 8 Landstar System 23d LCI International 22a Lear 2b Leggett & Platt 6b Lehman Brothers Holdings 17a Lennar 13b Lexmark Intl. Group 18b LG&E Energy 24a Liberty Financial 17b Lilly (Eli) 12b Limited 8 Lincoln Electric 15b Lincoln National 17b Liton Industries 9b	Living Centers of America 12c Liz Claiborne 6a Lockheed Martin 1 Longs Drug Stores 12a Louisiana-Pacific 19a Lowe's 8 LSI Logic 9d LTV 16b Lubrizol 4 Lucent Technologies 22a Lukens 16b Lyondell 4 Manpower 21e Mapco 11a Mark IV Industries 15a Marriott Intl 14b Marsh & McLennan 17a Marsh Supermarkets 10c Marshall Industries 21b Masco 13a Mattel 14c Maxam 16a May Department Stores 8 Maytag 6b MBNA 3a McCormick 10b McDermott Intl 15c McDonald's 14a McDonnell Douglas 1 McGraw-Hill 20b MCI Communications 22a McKesson 12a MCN Energy Group 24b M.D.C. 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For Nancy McCardel, the days start early. At 5:30 a.m., she gets up to feed her 3-month-old daughter before showering and dressing in a blouse and suit (\$300, plus \$12 a week for dry cleaning). She rouses her 8-year-old son, and during the summer, whisks him off to a day-care center (\$112 per week). She then drops off her daughter at another center (\$210 per week) across town.

Financially, the answer isn't clear. Although more than half of all women with preschool children hold paid jobs, many of them soon discover that much of their earnings are eaten up by the costs of child care, a professional wardrobe, and other work-related expenses. Ultimately, some women (and many men) argue it doesn't

The numbers certainly seem to support that assumption. For example, a hypothetical suburban couple working in New York City and whose combined income is \$150,000 saves more than \$15,000 in federal taxes, \$5,070 in FICA taxes, and \$5,184 in state and local taxes

Each family's spending habits vary so widely, of course, that it's almost impossible to generalize about how lucrative a second income actually is. And having the option to choose between working or staying at home with your child is a luxury that millions of single mothers and less-affluent families don't have. Still, on paper, it often seems that a second salary for a higher-income family doesn't mean much improvement in their standard of living—especially in the child's early years.

That determination is shocking, but also somewhat misleading. While a good chunk of



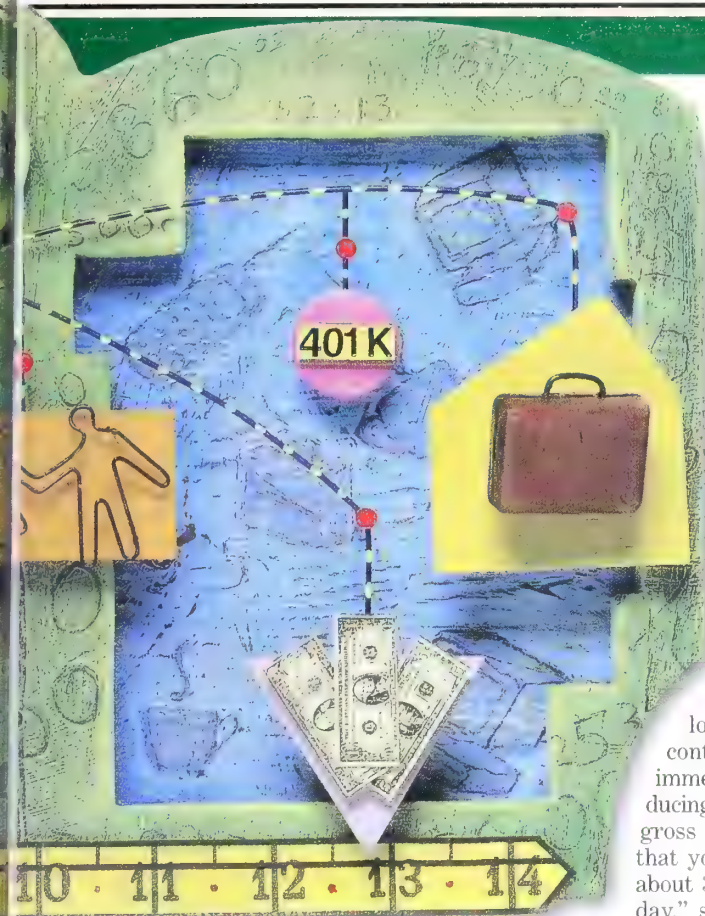
Grabbing a tuna on rye

from the fridge isn't as pricey as the lunch special down town, but you may wind up eating out lunch frequently with other stay-at-home moms and their tots. Every quick chat over a cup of coffee and danish will set you back three bucks. What's more, you may find yourself doing more shopping now that you have the time. That's not altogether a bad

GROSS INCOME (HUSBAND)
MINUS 401(K) CONTRIBUTION.
ADJUSTED GROSS INCOME (AGI)
MINUS TAXES:
 FEDERAL
 STATE & LOCAL
 FICA
TOTAL TAXES*
WHAT'S LEFT
PLUS PRETAX VALUE OF 401(K)

*The taxes are based on a taxable income of \$39,222, which results after deductions of \$14,937 for mortgage interest, for real estate taxes, and \$2,891 for state and local taxes, three exemptions worth \$7,950.

**Assuming a 10% annual contribution, 8% annual return, 50% employer match



if you shop the sales. babysitter costs won't minated entirely. You'll need to get away from ids—to run errands or time by yourself. e real problem in this however, is its short-view. Even if your take-pay covers little more your expenses, argues / Hounsell, executive di-r of the Women's Insti-

tute for a Secure Retirement in Washington, from a financial standpoint, it would still pay to work. "By remaining in the workforce, you're making a long-term investment in your career and future earnings," says Hounsell.

Child-care costs, the heftiest expense by far for most working mothers, don't last forever. Eventually, Junior will grow up and go to

school. And by that time, most working moms will have gotten a raise, maybe even a promotion, and regularly siphoned some cash into a 401(k) or similar retirement fund. Our New York professional would stockpile \$186,386 in her retirement plan over 10 years—if she keeps working.

Building up a 401(k) nest egg—if that's an option for you at your job—may be a hidden benefit of remaining in the workforce, both in the short and long term. The 401(k) contributions give you an immediate tax break by reducing your current adjusted gross income. "Every dollar that you put in will save you about 35¢ in federal taxes today," says Douglas Mollin, a certified financial planner with ProPlan in Elmhurst, N. Y. Over the long haul, the money you sock away into a 401(k) grows tax-deferred. Obviously, the more you put in over the years—and the earlier in your life that you do so—the larger your holdings will be upon retirement. And, if your employer matches all or part of your contribution, you're getting free money. "Think of it as an an-

nual, tax-deferred bonus," says Mollin, "that you'd be forfeiting if you quit." Using that logic, our New York professional earns not \$70,000 but \$73,500 annually.

Meanwhile, women who step out of the paid workforce for an extended period may find that they're earning power has diminished. "It's especially troublesome for women reentering who are over age 40," says Bermont. Unless they update their skills, returnees may earn less now than they did 5, 10, even 15 years ago when they stopped working to raise their kids.

FINANCIAL JEOPARDY. Stay-at-home moms may even be putting themselves in financial jeopardy. It's risky to depend on a single wage-earner, given the constant threat of layoffs. And divorce and widowhood—two real possibilities—often put nonworking wives in a precarious position, says Hounsell, if they forgo all responsibility for their financial future.

The bottom line doesn't tell the whole story, of course. "For many women, the decision to work, or not, involves more than money," says Norman M. Berk, managing partner of Berk Patterson, a financial planning firm in Birmingham, Ala. Some parents don't believe in day care. "Do I really want someone else raising my child?" asks Denise Larkin. For this 33-year-old former international portfolio trader, the answer was no. Larkin quit shortly after the birth of her first child last year.

Other mothers feel they must take a more active parenting role—at some point in their child's life. Ellen Bartel, 42, recently quit her job as vice-president for institutional advancement at Alverno College in Milwaukee. While she has worked full-time since her children were born, Bartel feels that her two boys, aged 8 and 9, need her full-time now. "They're asking more complicated questions," she says. "And

He Works, She Works

OME (HUSBAND)	80,000	AFTER-TAX INCOME	95,189
WIFE)	70,000	MINUS ADDITIONAL EXPENSES	
SS INCOME	150,000	CHILD CARE (\$400/WEEK)	-20,800
401(K) CONTRIBUTIONS:		PAYROLL TAXES FOR NANNY	-2,444
DIS	-8,000	COMMUTING**	-2,160
ERS	-7,000	LUNCHES OUT (\$7/DAY)**	-1,680
GROSS INCOME (AGI):	135,000	DRY CLEANING (\$50/MONTH)**	-550
TAXES*		TAKE-OUT DINNER (\$50/WEEK)**	-2,400
DERAL	-21,931	HOUSE CLEANING (\$50/WEEK)	-2,600
PENDENT-CARE EXPENSE CREDIT	480	TOTAL EXPENSES:	-32,634
ATE & LOCAL	-8,075	WHAT'S LEFT	62,555
CA	-10,285	PLUS PRETAX VALUE OF 401(K) SAVINGS***	23,343
ES:	-39,811	TOTAL	85,898

based on a taxable income of \$97,452, which results after 14,937 for mortgage interest, \$7,000 for real id \$8,075 for state and local taxes, plus three exemptions

**Based on a 52-week year—minus 2 weeks of vacation and 10 holidays

***Assuming a 10% annual contribution, 8% annual return, and 50% employer match

you only have a small window of opportunity when you can be influential in their lives."

Women who are committed to a career, on the other hand, often see their job—as many men do—as an integral part of their identity. And they may not be willing to give that up. Playing peek-a-boo and singing *Twinkle, Twinkle, Little Star* all day long can be tedious—even for the most nurturing of parents.

The spouses of working mothers are apparently hap-

WHAT SHE LOSES LONG-TERM

	SALARY*	401(K) BALANCE**
YEAR 1	\$70,000	\$10,894
YEAR 5	83,476	69,454
YEAR 10	104,027	186,386
YEAR 15	129,636	360,596

* Assumes a 4.5% increase per year

** Balance at yearend, given a 10% contribution of her salary per year, a 50% match "OF THAT 10%" by her employer, and an annual return of 8%

DATA: PRICE WATERHOUSE PERSONAL FINANCIAL SERVICES

pier, too. In *She Works/He Works: How Two-Income Families are Happier, Healthier, and Better Off* (\$24; Harper San Francisco),

clinical psychologist Rosalind Barnett explains the findings of her three-year study, funded by the National Institute of Mental Health, of 300 families in the Boston area. "When the husband and wife both work, it puts less stress on the marriage," says Barnett. "They have more security, and more flexibility."

If only real life were so simple. But add a sick child or a trusted nanny who has just quit, and even the best-

laid plans go awry. "I had to go out of town one week," says McCardell. "That'll really upset everyone's schedule." But she wouldn't think of giving up her job. "My work is challenging, and I need that," she says. Besides, that second income is keeping the far from track financially. The Cardels recently bought a new car and are trying to beef up their savings for kids' college education. "We couldn't do that if I didn't work," says McCardell. "Two incomes give us more choices." *Barbara He*

Money Tips From the Front

When parents have questions on child-rearing, they often turn to other parents for guidance. So to shed some light on the topic of money and kids, we recently polled parents on what worked and didn't work for them.

Our four-question survey, conducted via the Internet, yielded scores of fascinating responses, including a consensus that the smartest money goes to tuition, travel, and nonmaterial experiences. The dumbest? Fast food, hot fashions, and toys—especially video games.

Read on, and hear what else the voices of experience have to say.

Q: What is the smartest expenditure you have made on your children?

A: Amigos, a humanitarian exchange program, where they worked on rabies-vaccination programs in Honduras and Ecuador for a summer.

—Jon Beall, Austin, Tex.

A: Time. When we decided

to start a family, we began to bank 100% of my wife's salary in order to learn to live on one income. Then, when we finally did have a baby, my wife retired from her teaching career to spend time with the children.

—Jonathan

C. Kerr, Middletown, Ohio

A: Music lessons with a professional. Very expensive and very demanding. However, it has been a nurturing experience in which they have learned music along with discipline and responsibility.

—David A. Minster, Markham, Ontario

A: Two cats from a shelter.

—Barbara Heffner, Wellesley, Mass.

Q: What is the dumbest way you have spent money on your kids?

A: Separate college accounts under their individual names, which resulted in having to file extra IRS returns (mine is a big enough pain),

while also limiting their potential access to financial aid.

—Robin Cole, Stanford, Calif.

A: It must be the money my ex-husband has spent on video games.

—Anne Smith, Fremont, Calif.

A: A Visa card to be used for "emergencies" only.

—Bob Self, Helena, Ala.

A: Money to enable kids to buy me gifts. Dumb!

—John Johnson, Thomasville, Ga.

Q: How are you teaching your children to handle money responsibly?

A: Our son already has heard many times that...humans are creatures of unlimited wants but limited resources, so we must make choices.

—Rebecca Baldwin, Issaquah, Wash.

A: They have developed their own small businesses while in

school, have their own accounts, and use part of money to purchase the things they require for their sports and travels.

—Francisco J. Guevara, Mexico City

A: When they want something out of the ordinary, let them know in their terms how much it costs. My daughter wants to go on a houseboat vacation. We let her know it costs 200 Bear Babies.

—Robin V. Lawrence, Lawrenceville, Ga.

Q: What ways are you saving for your children's college education?

A: We are making a down house payment monthly. Our home will be paid off the same year our son heads to college. Then, we'll take out a new mortgage or refinance the home to pay for college.

—Nathan Bell, Oklahoma City, Okla.

A: Through a devoted and loyal relative.

—Sharyn Sullivan, Dickinson, Tex.

A: When each was born, we put \$100 into an account. Each payday after that, I put something in that account. It was the first check I wrote. And whenever we received a windfall, we always put something in, usually 15% to 25%.

—Hal Kelley, Montara, Calif.



The 1-2-3s of Hiring a Nanny

finding someone you can trust to care for your child is one of the most provoking tasks a parent faces. "You can't be careful when hiring and testing the performance of your child-care provider if you consider the time it takes up to 12 hours a week to be unsupervised in your home with your child," says Jerry Porrazzo, director of the Southern California Nanny Center in Lake Forest, a nonprofit organization.

It's why the nanny industry has blossomed to help with child-rearing and management. Nanny companies supply do-it-yourself nanny-hiring materials, including criminal and background checks, and sell in-home training programs. Once you've made your decision, nanny companies can even provide surveillance equipment to help you determine if you've made the right choice. Nannies are honest, conscientious, and loving people. Some parents may care about the latest techniques used out there that have been replaced.

RIGHT TALK. As an inexpensive alternative to the top shopping available employment agencies, the Southern California Nanny Center publishes *The Nanny Kit*. This \$18.50 comprehensive guide for parents of in-home child care includes screening and interviewing tips. It recommends using a job application to utilize the hiring process, keeping the relationship professional. Include past employment, child-care philosophy, previous addresses, and security number. Porrazzo's kit also suggests

briefly screening candidates over the phone, then sending them the application, and using the completed forms as a guide for in-person interviews. Ask open-ended and hypothetical questions and avoid turning the interview into a social event. Once you have a candidate in mind, contact at least three former employers and three personal references. To catch people posing as references, ask trick questions such as: "The nanny worked for you for two years, right?" when you know she worked for three years.

Once you've completed your pre-employment screening, a background check will search the candidate's criminal history and verify the social security number. Several corporate-investigation companies have recently added background checks for child-care providers for about \$65. "You want to make sure the candidate is who they say they are," says Frank Bucheit, manager of Background Research International in Falls Church, Va.



The search takes four days and doesn't require the applicant's O.K. The applicant must sign a release for you to get a copy of a driving record and credit history.

Hiring a nanny is just the beginning. You must also train and manage your new employee. "It's ironic that parents can work confidently at the office but feel uncomfortable and insecure when managing their child-care provider at home," says Marcia Zaiac Wasser, chairman of Interactive Family Management. She and her partner, Nancy Adler Manket, recently developed The Nanny Training Program, which includes a video and workbook that reviews the caregiver's responsibilities and suggests the right way to do tasks. There is also an employer handbook with nanny-management tips and a computer

disk with 13 worksheets, including a safety checklist and daily activity report.

TALE OF THE TAPE. Shortly after you hire your nanny, you'll want to evaluate performance. Come home unannounced, arrange for friends and family to make surprise visits, or—if you're really nervous—use hidden cameras. Sometimes, a nanny's interaction with the child stops as soon as a parent walks out the door. For about \$250, Babywatch, a provider of videotaping systems, will rent a hidden camera for three days. Some parents prefer full-time surveillance, with cameras placed throughout the home. These systems average about \$2,400.

Secret videotaping is controversial, and could damage the relationship with a trustworthy caregiver. However, if you're still interested, videotaping someone without consent is considered legal as long as no conversations are captured and the cameras aren't installed in bathrooms or bedrooms. That may change—so you may want to inform the nanny that she could be videotaped.

All of these tools just help you get through the selection process. Once you make it through that first stage, the most important part begins: the development of a bond between the nanny and your child.

Toddi Gutner

TOOLS FOR THE TASK

COMPANY	DESCRIPTION
THE SOUTHERN CALIFORNIA NANNY CENTER (714) 859-9134	Publishes <i>The Nanny Kit</i> (\$18.50), a step-by-step hiring guide with application forms and worksheets
THE INTERNATIONAL NANNY ASSN. (609) 858-0808	Supplies list of firms that do pre-employment background checks
INTERACTIVE FAMILY MANAGEMENT (888) 626-6921	Sells "The Nanny Training Program" (\$49.95) video, workbook, employer guide book, and computer disk
BABYWATCH (800) 558-5669	Provides videotaping equipment in 22 cities for monitoring caregivers

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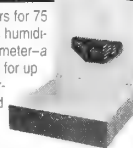
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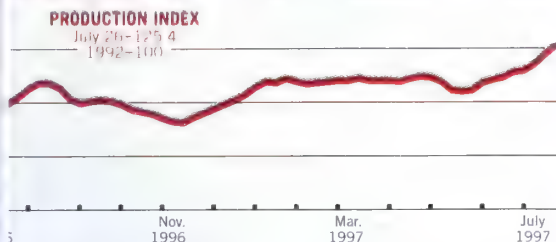
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PRODUCTION INDEX

Change from last week: 0.6%
Change from last year: 3.9%



The production index rose during the week ended July 26. Before calculation of the four-week moving average, the index rose to 127.3 from 126.0. In the week, the seasonally adjusted levels of auto and truck production rose, as more car plants returned to production. Rail-freight traffic and oil refining also posted gains. Steel production increased slightly. Output of both coal and lumber declined, and electric power output also fell.

Source: Index copyright 1997 by The McGraw-Hill Companies

PRICING INDICATORS

	LATEST WEEK	WEEK AGO	YEARLY % CHG
PRICES (8/1) S&P 500	947.14	938.79	43.0
RATE BOND YIELD, Aaa (8/1)	7.01%	7.09%	-7.2
TRADING MATERIALS PRICES (8/1)	107.8	107.3	0.5
TELEPHONE FAILURES (7/25)	NA	NA	NA
STATE LOANS (7/23) billions	NA	NA	NA
MONEY SUPPLY, M2 (7/21) billions	\$3,931.0	\$3,927.1r	4.8
UNEMPLOYMENT CLAIMS (7/26) thous.	277	299	-6.7

S: Standard & Poor's, Moody's, Journal of Commerce (index 1990=100), Reserve, Labor Dept

INTEREST RATES

	LATEST WEEK	WEEK AGO	YEAR AGO
BANK AL FUNDS (8/5)	5.48%	5.52%	5.10%
COMMERCIAL PAPER (8/6) 3-month	5.56	5.57	5.43
NEGOTIABLE CERTIFICATES OF DEPOSIT (8/6) 3-month	5.61	5.58	5.40
MORTGAGE (8/1) 30-year	7.50	7.60	8.41
FIXED RATE MORTGAGE (8/1) one-year	5.67	5.75	6.14
LIBOR (8/1)	8.50	8.50	8.25

S: Federal Reserve, HSH Associates, Bloomberg Financial Markets

Data in the production indicators are seasonally adjusted in computing the BW index (chart); other components (estimated and not listed) include machinery and defense equipment. 1=Western Wood Products Assn. 2=Southern Forest Products Assn. 3=Free market value NA=Not available r=revised NM=Not meaningful

THE WEEK AHEAD

ACTIVITY AND COSTS

Monday, Aug. 12, 10 a.m. EDT ▶ Output of nonfarm businesses grew by a small 0.5% annual rate in the second quarter. That would be quite less than the 2.6% gain in the first. If farm unit labor costs probably rose in the second quarter, the same large increase posted in the first quarter.

SALES

Tuesday, Aug. 13, 8:30 a.m. EDT ▶ Sales probably increased by 0.4% in July, on top of a 0.5% gain in June, according to the median forecast of economists issued by MMS International, one of The McGraw-Hill Companies. The gain is sug-

gested by weekly surveys of retail chains. Excluding cars, store sales likely rose 0.4% last month after a 0.3% increase in June.

PRODUCER PRICE INDEX

Wednesday, Aug. 13, 8:30 a.m. EDT ▶ Producer prices for finished goods likely edged up just 0.1% in July, following a 0.1% drop in June. Excluding food and energy prices, the core rate also likely rose 0.1% in July as it did in June.

BUSINESS INVENTORIES

Thursday, Aug. 14, 8:30 a.m. EDT ▶ Inventories held by factories, wholesalers, and retailers probably rose 0.3% in June, after growing 0.2% in May.

CONSUMER PRICE INDEX

Thursday, Aug. 14, 8:30 a.m. EDT ▶ Consumer prices of goods and services likely rose 0.2% in July, says the MMS survey. Core prices probably were also up 0.2% last month. In June, both the total price index and the core index increased just 0.1%.

INDUSTRIAL PRODUCTION

Thursday, Aug. 14, 9:15 a.m. EDT ▶ Output at the nation's factories, mines, and utilities likely rose just 0.2% in July, on top of a 0.3% increase in June. A strike and retooling in the auto industry held back overall production gains. As a result, the average operating rate for all industry in July likely remained at June's 83.5%.

PRODUCTION INDICATORS

	LATEST WEEK	WEEK AGO	YEARLY % CHG
STEEL (8/2) thous. of net tons	1,922	1,983#	-4.2
AUTOS (8/2) units	115,986	108,312r#	-7.7
TRUCKS (8/2) units	117,509	107,672r#	11.5
ELECTRIC POWER (8/2) millions of kilowatt-hrs.	74,982	74,851#	4.4
CRUDE-OIL REFINING (8/2) thous. of bbl./day	15,000	14,827#	4.9
COAL (7/26) thous. of net tons	20,945#	20,710	-0.7
LUMBER (7/26) millions of ft.	505.1#	506.4	3.7
RAIL FREIGHT (7/26) billions of ton-miles	26.6#	25.9	-0.7

Sources: American Iron & Steel Institute, Ward's Automotive Reports, Edison Electric Institute, American Petroleum Institute, Energy Dept., WPPA1, SFFPA2, Association of American Railroads

PRICES

	LATEST WEEK	WEEK AGO	YEARLY % CHG
GOLD (8/6) \$/troy oz.	319.350	327.550	-17.7
STEEL SCRAP (8/5) #1 heavy, \$/ton	143.50	143.50	7.1
COPPER (8/1) ¢/lb.	113.5	113.9	18.0
ALUMINUM (8/1) ¢/lb.	81.0	77.5	14.1
COTTON (8/2) strict low middling 1-1/16 in., ¢/lb	72.47	72.37	-5.8
OIL (8/5) \$/bbl.	20.54	19.56	-4.3
CRB FOODSTUFFS (8/5) 1967=100	238.50	240.70	-13.3
CRB RAW INDUSTRIALS (8/5) 1967=100	341.08	339.66	0.2

Sources: London Wednesday final setting, Chicago market, Metals Week, Memphis market, NYMEX, Commodity Research Bureau

FOREIGN EXCHANGE

	LATEST WEEK	WEEK AGO	YEAR AGO
JAPANESE YEN (8/6)	118.83	118.33	108.04
GERMAN MARK (8/6)	1.87	1.84	1.48
BRITISH POUND (8/6)	1.60	1.63	1.55
FRENCH FRANC (8/6)	6.33	6.19	5.05
ITALIAN LIRA (8/6)	1835.5	1787.5	1518.0
CANADIAN DOLLAR (8/6)	1.38	1.38	1.37
MEXICAN PESO (8/6)	7.779	7.780	7.530
TRADE-WEIGHTED DOLLAR INDEX (8/6)	107.7	106.5	97.1

Sources: Major New York banks. Currencies expressed in units per U.S. dollar, except for British pound in dollars. Trade-weighted dollar via J.P. Morgan

Index to Companies

This index gives the starting page for a story or feature with a significant reference to a company. Most subsidiaries are indexed under their own names. Companies listed only in tables are not included.

A

Acer 68, 139
Acorn Computer Group 144
Addison Wesley 6
Adobe Systems (ADBE) 87, 106
Advanced Micro Devices (AMD) 123, 158
Advanced RISC Machines 144
Aetna Life & Casualty (AET) 50
Agrium 58
Agro-Invest 58
Alpine Technology 123
Amazon.com 87, 138
American Classic Voyages (AMCV) 156
American Express (AXP) 156
AMR (AMR) 148
Analysys 144
Andersen Consulting 17, 54
Apple Computer (AAPL) 1, 4, 13, 24, 44, 66, 68, 87, 126, 138
Applied Materials (AMAT) 87, 123, 134
Arbor Software (ARSW) 87
Argonaut Capital (AGIL) 148
Ascend Communications (ASND) 87, 106
Asia Motors 56
Ask Computer 136
AT&T (T) 4, 17, 158
Atari (ATC) 146
Atherton Technology 68
@Home 106, 124
Audi 38
August Capital 87
Autodesk (ADSK) 136
Autostereo Systems 144

B

Babywatch 195
Background Research International 195
BackWeb 134
Bain 17
BankAmerica (BAC) 87
Bankers Trust (BT) 152
Bank Julius Baer 57
Bank of Tokyo-Mitsubishi 152
Battery Ventures 138
Bayer Group 57
Bay Networks (BAY) 87
Be 146
BEA Systems 124
Bell Labs 138
Benchmark Capital 106
Benetton 58
Berk Patterson 192
Bernstein (Sanford C.) 44
BMW 148
Boehringer Mannheim 17
Borland International (BORL) 85
Boston Consulting 17
British Telecommunications (BTY) 144
Broadview Associates 87, 124
BroadVision 99

C

Cabletron (CS) 50

Cadence (CDN) 123
Caesars World (ITT) 50
Calico Technology 68, 106
Cambridge University Press 6
Capital Credit 149
Cargill 58
CCH 53
C-Cube Microsystems (CUBE) 123
Centillum Technology 99
Chase Manhattan (CMB) 152
Chips & Technologies (CHPS) 76
Chrysler (C) 38, 44, 68, 158
CIGNA (CI) 13
Cirrus Logic (CRUS) 99, 123
Cisco Systems (CSCO) 68, 87, 102, 106, 124, 130, 134, 138, 146
Citicorp (CCI) 148
Cityscape Financial 149
CNBC 1
C/NET (CNWK) 87, 124, 130, 134, 146
Coastal Capital 149
Coca-Cola (KO) 148
Collaborative Economics 76
Columbia/HCA Healthcare (COL) 50
Compaq Computer (CPQ) 87
Com21 106
Connectix 24
Corestates Financial (CFL) 50
CorpTech 136
Creative Strategies 44
Crédit Lyonnais 50
Credit Suisse First Boston 87, 158
Cresud 58
Crossroads Software 124
CSC Continuum 106
CyberCash 87

D

Daewoo 56
Daisy Systems 68
Dell Computer (DELL) 87, 158
Deutsche Bank (MSFT) 152
Deutsche Morgan Grenfell 87
Digital Equipment (DEC) 76, 136, 138
Dillon Read 46
Doblin Group 146
Dongkuk Steel 56
Draper Fisher Jurvetson 68
DRI/McGraw-Hill (MHP) 158, 160
DuPont Merck (MRK) 46

E

Eli Lilly (LLY) 158
E.M. Warburg Pincus 124
Encsson (L.M.) (ERICY) 148
Ernst & Young 32
ESS 123
E*Trade Group (EGRP) 68, 87, 124
Excite (XCIT) 68, 124, 126, 146

F

Ferring Pharmaceuticals 46
Fidelity Bank (MRBK) 50

Financial Research 154
Financial Service Analytics 158
Firepower Systems 68
First Chicago NBD (FCN) 38
First Manhattan Consulting Group 152
Fisher Scientific (FSH) 50
Ford (F) 38, 68, 76, 158
Franklin Advisors 149
Fry's Electronics 87

G

Gain Technology 99
Gateway 2000 (GATE) 138
Geers Horakustik 57
General Electric (GE) 148
General Magic (GMGC) 68, 124
General Motors (GM) 38, 50, 68, 76, 158
Genesis Merchant Group 156
Girl Tech 136
Glaxo Wellcome (GLX) 46, 138
Goldman Sachs 54
Guinness 17

H

Hambrecht & Quist (HMQ) 87, 106, 123, 126
Hanbo Group 56
Healthcon 106
Heidrick & Struggles 87
Hennesse Group 148
Hewlett-Packard (HWP) 66, 106, 136, 138, 139
Hilton Hotels (HLT) 50
Hitachi (HIT) 68, 144
Honda (HMC) 38
Hummer Winblad Venture Partners 106, 87
Hyundai 56

I

IBM (IBM) 4, 44, 85, 126, 138, 142, 148
IDEO 82
Informix (IFMX) 82
Infoseek (SEEK) 99, 124
Insignia Systems 24
Institutional Venture Partners 106
Intel (INTC) 1, 66, 68, 76, 82, 85, 87, 123, 138, 142, 146, 148, 156, 158, 202
Interactive Family Management 195
Intuit (INTU) 44, 126
Ionica 144
IRSA Inversiones y Representaciones 58
ITT (ITT) 50

J

Jacobs & Associates 38
Jaguar 13

K

Keefe Bruyette & Woods 152
Kemper Growth Fund 154
Kia Group 56
Kleiner Perkins Caufield & Byers 66, 68, 82, 85, 106, 124, 146
Kohlberg Kravis Roberts 50

L

Lancer Partners 156
Lehman Brothers (LEH) 149, 156
Lincoln National (LNC) 13
Lipton (Thomas J.) 6
Lycos (LCOS) 124

M

Macromedia (MACR) 68
Madero Lanusse Belastegui 58
Marimba 124, 136
Mayfield Fund 68, 106
Mazda 13, 38
McGraw-Hill (MHP) 6, 199
MCI Communications (MCI) 158
McKenna Group 87
McKinsey 17
Menlo Ventures 99
Mercedes-Benz (DAI) 38
Mercury Finance 149
Merrill Lynch (MER) 47, 152, 158
MetaCreations (MCRE) 24
MGM 50
Microsoft (MSFT) 24, 44, 64, 68, 76, 85, 87, 106, 124, 138, 142, 144, 158, 202
MIPS 82
MMS International (MHP) 199
Monsanto (MTC) 138
Moody's Investors Service 149
Morningstar 154

N

Nabisco (RN) 58
National Semiconductor (NSM) 87
NationsBank (NB) 152
NeoMagic 99
Netcom (NETC) 87, 124
NetGravity 134
Netmosphere 68
NetObjects 126
Netscape Communications (NSCP) 68, 76, 85, 87, 106, 124, 126, 130, 134, 138
Network Computing Devices (NCDI) 102
New England Electric (NES) 50
New Enterprise Associates (DELL) 106
New York Life 13
NexGen 123
NeXT Software 66
Nissan 38
Nokia 144
Northwest (NWAC) 158
Norwest Venture Capital 138
Nynex (NYN) 50

O

Olivetti 144
Omega Fund 148
Oracle (ORCL) 44, 68, 85, 87, 124, 126, 130, 138, 144
Oxford Health Plans (OXHP) 44, 156
Oxford University Press 6

P

Pacific Bell (PAC) 4

Pacific Gas & Electric (PG&E) 50
Pacific Telesis (PAC) 158
Paging Networks (PAGE) 50
Payment Systems 126
PCs Health Services 158
Peery/Arrillaga 87
Perez Compac 58
Philco Argentina 58
Philip Morris (MO) 36
Pixar (PIXR) 87
Pxxera 123
PlanetWeb 99
Pohang Iron & Steel (PKX) 56
Pointcast 68, 134
Power Computing 24
Power (D.J.) 13
Powersoft 87
Precept Software 102
Price Waterhouse 68
Progressive 16E2
Progressive Networks 138
Prompt Software 99
ProPlan 192
Prudential Securities 160

Q

Qiagen 57
Quantum Fund 148
Quantum Industrial Partners 58
Quanta 124
Quota Fund 148

R

Rambus (RMBS) 124
Raychem (RYC) 99
Robertson Stephens 87
Rockwell International (ROK) 4

S

Saab 38
Salomon Brothers (SB) 57, 158
Sammi Steel 56
Samsung Group 56
SAS Software 138
SBC Communications (SBC) 4, 158
SBC Warburg 139
Schroder Wertheim 38
Schwab (Charles) (SCH) 124, 154
Scudder Stevens & Clark 154
Seagate Technology (SEG) 106, 124, 146
Searle (G.D.) (MTC) 46
Sears (S) 17
Sequoia Capital 87, 99, 123
Serono Laboratories 46
Sessionware 85
SGS-Thomson Microelectronics (STM) 156
Shanghai Huayi 54
Siebel Systems (SEBL) 68, 87, 99, 124, 130
Silicon Graphics (SGI) 68, 82
Silicon Valley Bank 87
Simplex Solutions 68
Softbank 87
Solentron 123
Sony (SNE) 68, 139, 142
Soros Fund Management 148
SouthTrust Bank (SOTR) 36
Sprint (FON) 50, 158
Standard & Poor's (MHP) 48

Sterling Gas & Electric (ISEE) 156
S3 (SIII) 123
Sun Microsystems (SUNW) 76, 82, 85, 87, 134, 136
Synopsis 106

T

Tandem Computer (TDM) 138, 146
Tektronix (TEK) 99
Tele-Communications (TCOMA) 106
Teleport Communications (TCGI) 4
Terayon 106
Texas Instruments (TXN) 106
3Com (COMS) 68, 87, 106, 123
Tiger Fund 148
Toll Brothers (TOL) 47
Toshiba 123, 139
Toyota (TOYOY) 38
Transamerica (TA) 158
Travelers Group (TRV) 152
Trident (TRID) 123
Trimtab Management Systems 13
TriNet Employer 68
T. Rowe Price (TROW) 47
21st Century Internet Venture Partners 124

U

Ungermann-Bass (TDM) 138
United Microelectronics 138
UPS 33, 40, 41
USWeb 87

V

Van Hedge Advisors 148
Venrock Associates 138
Venture Law Group 87
VentureOne 68, 106, 124
Visigenic Software (VSGN) 148
Volkswagen 38, 148
Volvo 38

W

Walsh Securities 149
Wang Laboratories (WANG) 148
WebTV 87, 124
Weiss Peck & Greer 106
WFD 192
Wilson Sonsini Goodrich & Rosati 68, 82, 85, 87
Wind River Systems 87
WorldCom (WCOW) 106
Wyeth-Ayerst Laboratories (AHP) 46

X

Xerox (XRX) 144
Xilinx (XLNX) 136
XKL Systems 102

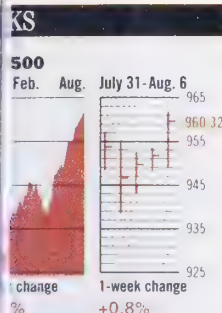
Y

Yahoo! (YHOO) 82, 87, 106, 123, 124, 130
YPF 58

Z

Zilog (ZLG) 102
Zurich Kemper Investments 154

Investment Figures of the Week



ENTARY

nd rally came to an abrupt
Aug. 1, when fears of
economic growth led to
st one-day rout in several
But stocks resisted the
in rates, and the major
indexes all climbed to
ghs. Technology investors
out well: IBM and Intel
st record highs. The out-
and stock price—of long-
ing Apple Computer bright-
considerably on Aug. 6
software giant Microsoft
will take a \$150 million
in the company. Apple
jumped over \$6, a 32%
y gain.

U.S. MARKETS	Latest	% change Week	Year
Dow Jones Industrials	8259.3	0.1	44.4
NASDAQ Combined Composite	1630.4	2.7	44.4
S&P MidCap 400	319.1	1.7	40.6
S&P SmallCap 600	175.1	2.5	35.6
S&P SuperComposite 1500	205.7	1.0	44.1

SECTORS	Latest	% change Week	Year
Bloomberg Information Age	309.5	3.8	54.0
S&P Financials	110.5	-0.4	61.3
S&P Utilities	200.9	-0.1	6.5
PSE Technology	337.7	4.3	69.5

FOREIGN MARKETS	Latest	% change Week	Year
London (FT-SE 100)	5026.2	2.0	31.9
Frankfurt (DAX)	4335.4	-2.0	71.2
Tokyo (NIKKEI 225)	19,702.1	-2.5	-3.8
Hong Kong (Hang Seng)	16,541.6	3.5	48.6
Toronto (TSE 300)	6933.7	1.2	38.0
Mexico City (IPC)	5212.9	4.8	62.6

FUNDAMENTALS	Latest	Week ago	Year ago
S&P 500 Dividend Yield	1.57%	1.59%	2.17%
S&P 500 P/E Ratio (Last 12 mos.)	23.9	23.7	19.0
S&P 500 P/E Ratio (Next 12 mos.)*	19.1	19.1	NA
First Call Earnings Surprise*	2.36%	2.39%	NA

TECHNICAL INDICATORS	Latest	Week ago	Reading
S&P 500 200-day average	802.2	796.0	Positive
Stocks above 200-day average	83.0%	81.0%	Negative
Options: Put/call ratio	0.45	0.45	Negative
Insiders: Vickers Sell/buy ratio	2.98	2.90	Negative

Data: Bloomberg Financial Markets; *First Call Corp.

BEST-PERFORMING GROUPS	Last month %	Last 12 months %
Semiconductors	28.0	Semiconductors 129.6
Computer Systems	23.9	Trucking 110.4
Homebuilding	20.0	Oil & Gas Drilling 105.7
Paper Containers	14.8	Savings & Loans 97.2
Oil Well Equipment & Svcs.	13.4	Computer Systems 96.8

WORST-PERFORMING GROUPS	Last month %	Last 12 months %
Hospital Management	-13.1	Gold -22.1
Photography/Imaging	-9.8	Photography/Imaging -11.3
Metal & Glass Containers	-5.1	Engineering & Constr. -2.0
Defense Electronics	-4.8	Hospital Management 2.2
Diversified Health Care	-3.7	Electric Companies 2.4

BLOOMBERG MONEY FLOW ANALYSIS

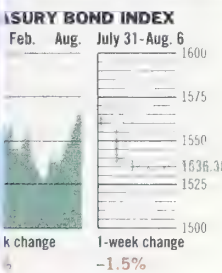
Rebound ahead? Stocks with most significant buying on price weakness

	Price	1-month change
Telebras-ADR	134 1/8	-27 3/4
Coca-Cola	68	-1 1/8
Merck	103	-1 1/2
Aetna	102 3/4	-1 9/16
Wells Fargo	271 3/8	-7 1/8
U S West Communications	36 3/8	-2 3/8

Decline ahead? Stocks with most significant selling on price strength

	Price	1-month change
Intel	99 11/16	26
Microsoft	143 5/16	13 13/16
Dell Computer	81 3/8	19 1/16
Amgen	57 5/16	1/16
Ascend Communications	53 3/16	6 1/8
McAfee Associates	69 1/4	4 1/2

REST RATES



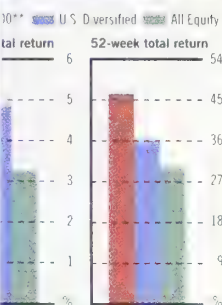
KEY RATES	Latest week	Week ago	Year ago
MONEY MARKET FUNDS	5.17	5.17	4.94
90-DAY TREASURY BILLS	5.28	5.23	5.19
6-MONTH BANK CDS	5.17	5.18	5.02
1-YEAR TREASURY BILLS	5.50	5.43	5.61
10-YEAR TREASURY NOTES	6.21	6.04	6.54
30-YEAR TREASURY BONDS	6.48	6.33	6.76
LONG-TERM AA INDUSTRIALS	6.93	6.78	7.29
LONG-TERM BBB INDUSTRIALS	7.29	7.14	7.67
LONG-TERM AA TELEPHONES	7.19	7.04	7.51

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 31% federal tax rate.

	10-yr. bond Latest week	10-yr. bond Last week	30-yr. bond Latest week	30-yr. bond Last week
GENERAL OBLIGATIONS	4.58%	4.48%	5.16%	5.06%
PERCENT OF TREASURIES	73.79	74.20	79.68	80.04
TAXABLE EQUIVALENT	6.64	6.49	7.48	7.33
INSURED REVENUE BONDS	4.74	4.64	5.40	5.30
PERCENT OF TREASURIES	76.36	76.85	83.39	83.84
TAXABLE EQUIVALENT	6.87	6.72	7.83	7.68

MUTUAL FUNDS



EQUITY FUNDS

Leaders	Four-week total return	%	Laggards	Four-week total return	%
Robertson Steph. Info. Age A	19.7		DFA Japanese Small Co.	-13.6	
Fidelity Select Computers	19.2		Wright EquiFd.-SwitzerInd	-8.9	
Steadman American Industry	18.7		Fidelity Japan Small Co.	-7.4	
Fidelity Select Electronics	16.8		Merrill Emerging Tigers B	-7.0	
Steadman Investment	15.9		Wright EquiFd.-Belg/Lux	-6.5	
Leaders	52-week total return	%	Laggards	52-week total return	%
Lexington Troika Russia	143.1		United Svcs. Gold Shares	-48.2	
ITT Hartford Cap. Apprec. A	98.2		Frontier Equity	-47.4	
Fidelity Select Electronics	90.8		Bull & Bear Gold Investors	-44.4	
American Heritage	89.8		Morgan Stan. Inst. Gold A	-43.0	
Fidelity Select Energy Serv.	81.2		Lexington Strategic Invmtnts.	-40.8	

EQUITY FUND CATEGORIES

Leaders	Four-week total return	%	Laggards	Four-week total return	%
Technology	11.7		Japan	-3.1	
Small-cap Growth	6.3		Europe	-1.9	
Mid-cap Growth	6.3		Foreign	-1.8	
Natural Resources	5.8		Latin America	-1.0	
Small-cap Blend	5.7		Diversified Pacific/Asia	-0.6	
Leaders	52-week total return	%	Laggards	52-week total return	%
Financial	53.4		Precious Metals	-29.2	
Technology	48.7		Japan	-6.3	
Latin America	47.3		Diversified Pacific/Asia	6.7	
Large-cap Growth	42.4		Pacific/Asia ex-Japan	15.9	
Large-cap Blend	41.4		Utilities	18.3	

re as of market close Wednesday, Aug. 6, 1997, unless otherwise indicated. Industry
clude S&P 500 companies only. Fundamentals, technical indicators, Bloomberg mon-

ey flow analysis, and mutual fund returns are as of Aug. 5. For a more detailed explanation, write
to us or E-mail figures@businessweek.com. NA=Not available **Vanguard Index 500 Fund

THE RICH ECOSYSTEM OF SILICON VALLEY

Technology and globalization, the two most powerful forces of our age, find their nexus today in that consistently amazing place, Silicon Valley. To be sure, other locations exist where ideas hum through the office hallways, where the future is written every day in computer code. Microsoft Corp., a continual prod to companies in the Valley, is lodged way north in Redmond, Wash. And chip-makers and computer makers blanket Asia. But in the globally integrated, high-tech arena, no other locale has the heft, the mass, the sheer significance of Silicon Valley. Today, one-fifth of the world's 100 largest high-tech companies make their home there, and the top five alone boast combined revenues of \$40 billion, with a market capitalization exceeding \$250 billion. Today, in this sunny valley where suburban office sprawl stretches across what formerly were orchards, people come from around the world to promote their ideas, make some money, and change the world.

Over the past 40 years, thousands of companies, hundreds of new products, and millionaires by the bushel have emerged from this fertile basin. Laboring in those now-famous garages, Stanford University grads William Hewlett and David Packard developed the audio oscillator; a generation later, Steven P. Jobs and Stephen Wozniak cobbled together the first personal computers for the consumer market. In many ways, their experiences reveal the quintessential story of American invention—that anyone with a good idea, perseverance, and a little bit of help from the right people can make it. Nearly two centuries ago, Robert Fulton, a jeweler's apprentice taken with the potential of water transport, tinkered and experimented, and with backing from U.S. ambassador to France Robert R. Livingston, designed the first steamboat, which plied the Hudson River in 1807. Thomas Alva Edison, of course, was the ultimate inventor-entrepreneur. With more than 1,000 patents to his name, he brought countless inventions into use, toiling in his New Jersey laboratory with craftsmen from England and Switzerland at his side.

But in Silicon Valley, the process of innovation and commercialization has gone way beyond anything that came before—in scale, in wealth creation, and in the diffusion of technology to the rest of the world. How did this happen? The Valley has its heroes and its legends, to be sure. But no one person, or even any collection of individuals, made the powerhouse that is Silicon Valley today. It is, rather, the quotidian way that people, ideas, and money come together in endlessly different combinations. You could call it a cluster. That's how Michael Porter described the beehives of specialized industrial activity in northern Italy, central Germany, and elsewhere in his 1990 book, *The Competitive Advantage of Nations*. Interestingly, companies in Silicon Valley for the most part aren't vertically integrated, and they buy everything they need from other firms in a tightly connected network of local suppliers. That's much the

way companies behave in clusters elsewhere in the world.

You might do better, though, to characterize Silicon Valley as a rich ecosystem, as does Hungarian-born Intel Corp. Chief Executive Andrew S. Grove. Within that ecosystem, teeming species, some unique to the Valley. Brash young techies who careen down slides to get to their meetings. Double-quick. Dreamers who hammer out concepts for products while trading ideas over a beer. Venture capitalists who put up the dough for startups. New companies that crash and burn. Secretaries who become millionaires. For all like these you don't find anywhere else—at least not all in the same place. The habitat is unique, and as long as those precious nutrients, ideas and money, keep flowing, the population and the species seem to flourish.

The rest of America—indeed, the rest of the world—could take a cue from that pulsating environment where brains, not brawn, are paramount, and knowledge is the great leveler. What college you went to doesn't matter (though many went to Stanford University or the University of California at Berkeley). It makes no difference if you're from Buffalo or Bombay. In Silicon Valley, hierarchies have been flattened, daredevil risk-taking encouraged, mistakes tolerated, and hard work generously rewarded with stock options and perks. To varying degrees, these tenets have been accepted and adopted elsewhere in Corporate America. Too often, though, while knowledge and brainpower may be recognized as the key assets in the Information Economy, they aren't given the environment in which to flourish. Managers may talk about leveling hierarchies but do little to see that accomplished. Risk-taking may be encouraged, but, truth be told, publicly held companies can't afford to make mistakes the way a startup can. Generous largesse in the form of special compensation plans has yet to spread through the lower ranks of Corporate America, despite the fact that top managers have become convinced that incentives matter.

Still, the denizens of Silicon Valley should not be too smug. Hubris is often a byproduct of stunning success, and Silicon Valley has its share of both. It pays to remember that technological systems can become unstable. Even today, Silicon Valley is in Eden. Sky-high housing costs mean that even people with middle-class incomes are shut out of affordable housing, and pockets of poverty persist among the plenty. And Silicon Valley, as it has before, may run into unforeseen problems and constraints. Only a decade ago, the semiconductor industry, battling stiff Japanese competition, received trade protection. In its earlier years, Silicon Valley got one-quarter of its orders from the government. Yet the region has been able to adapt and reinvent itself, and competition from without has only to further that process. But as Silicon Valley's "repeaters"—those folks who failed and survived to try something new—can tell you, there is no such thing as a sure thing.

